United States Courts
Southern District of Texas
FILED

VH MAY 0 8 2002

Michael N. Milby, Clerk

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, ET AL.,	§	
	§	
Plaintiffs,	§	
	§	**CIVIL ACTION NO: H-01-3624**
v.	§	**AND CONSOLIDATED CASES**
	§	
ENRON CORPORATION, ET AL.,	§	
	§	
Defendants.	§	

DEFENDANT KENNETH L. LAY'S MOTION TO DISMISS PLAINTIFFS' CONSOLIDATED COMPLAINT AND SUPPORTING BRIEF

James E. Coleman, Jr.
State Bar No. 0457400
Southern District ID No. 04574000
CARRINGTON, COLEMAN, SLOMAN
& BLUMENTHAL, L.L.P.
200 Crescent Court, Suite 1500
Dallas, Texas 75201
(214) 855-3000 (telephone)
(214) 855-1333 (telecopy)

ATTORNEY IN CHARGE FOR
DEFENDANT KENNETH L. LAY

OF COUNSEL:

Bruce W. Collins
State Bar No. 04604700
Southern District ID No. 20110
Sharon J. Shumway
State Bar No. 00791660
Southern District ID No. 30561
Carrington, Coleman, Sloman & Blumenthal, L.L.P.
200 Crescent Court, Suite 1500
Dallas, Texas 75201
(214) 855-3000 (telephone)
(214) 855-1333 (telecopy)

683

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Page**

Statutes, Rules and Regulations

Other Authorities

DEFENDANT KENNETH L. LAY'S MOTION TO DISMISS PLAINTIFFS' CONSOLIDATED COMPLAINT AND SUPPORTING BRIEF

TO THE HONORABLE MELINDA HARMON:

Pursuant to Rules 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(3)(A), Defendant Kenneth L. Lay respectfully requests that the Court dismiss entirely the claims asserted against him in Plaintiffs' Consolidated Complaint. In support of his request, Mr. Lay shows the Court the following:

I. Introduction

In July 2001, according to plaintiffs' version of reality, Ken Lay agreed to step back into the position of chief executive officer at Enron because Jeff Skilling told him that the "Enron house of cards was crumbling." Plaintiffs' Consolidated Complaint ("Compl.") ¶ 57. Then, over the next few months, Ken Lay allegedly committed fraud because he actually had the temerity, as chief executive officer, to make comments supportive of the company -- which the markets proceeded to ignore. In the meantime, having waited for the price of Enron stock to fall from $90 to under $50 per share, Ken Lay decided to sell more of his shares to take advantage of the fraud he supposedly helped orchestrate to drive the price up to $90 per share. Ken Lay also was so anxious to perpetuate this fraud that, within two months after he became CEO, the Raptor transactions were unwound and Enron reported a $1 billion charge to earnings and a $1.2 billion adjustment to shareholder equity on October 16, 2001 -- a disclosure that so shocked the markets that the price of Enron shares closed up on October 16, 2001. Allegedly driven to inflate Enron's stock price by a desire to maximize his own personal profits from stock sales, Ken Lay somehow missed the opportunity to sell nearly $500 million of his personal Enron holdings -- despite allegedly knowing that the house of cards would "crumble" at any time. Ken Lay was so sure that the company would shortly collapse that in the summer of 2001 he spent $4.6 million acquiring additional Enron shares.

As one federal district judge has written, the Court is not required to leave its common sense at the courthouse steps. *Thornton v. Micrografx, Inc.*, 878 F. Supp. 931, 938 (N.D. Tex. 1995). The time has come for careful, measured analysis of the particular facts pled by plaintiffs to determine whether they conform to the strict requirements of federal securities law. The test for compliance is not how many times plaintiffs can use variations on the phrase "house of cards" in a 500 page pleading. Plaintiffs must plead with particularity the "who, what, when, and where" of each misrepresentation that Ken Lay allegedly made, and provide a detailed explanation as to why each misrepresentation was allegedly false. As to all the misrepresentations allegedly made by Lay, plaintiffs must plead particular facts raising a strong inference that he acted with an intent to defraud investors or that he was severely reckless in not knowing that he was defrauding investors. In 500 pages, however, plaintiffs attribute very few representations specifically to Ken Lay, and those representations are typically the "cheerleading" type comments often made by chief executive officers that courts have repeatedly found to be non-actionable.

Plaintiffs' allegation of scienter rests almost entirely upon their claim that Ken Lay sold too much stock for too much money during the class period. Many senior executives from 1998 to 2001 sold many shares for many millions of dollars. This was also a period that saw an explosion in the number of employee stock options awarded to executives. For much of the time investors bought and sold stocks for dizzying profits, until the technology bubble burst. Yet, because Lay received extensive employee stock options and chose to exercise some of them and sell shares for a substantial amount of money over the same three-year period, he is supposedly guilty of fraud. Plaintiffs must do much more than simply allege that Ken Lay made a lot of money selling Enron stock to raise a strong inference of scienter. When the true facts about Ken Lay's stock selling, as disclosed in his SEC filings, are brought to light, it is exceedingly clear that Ken Lay did not believe for a moment that Enron was a house of cards about to collapse and that its stock price was grossly inflated. The trading record shows instead that he believed that the company would continue to grow and prosper. That he turned out to be wrong is not the basis for a securities fraud claim.

II. The Plaintiffs' 10b-5 Claims Must be Dismissed Because Their Allegations of Scienter are Insufficient Under FED. R. CIV. P. 9(b) and the Private Securities Litigation Reform Act of 1995

Plaintiffs must plead their § 10(b) and 10b-5 claims in compliance with FED. R. CIV. P. 9(b) and the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4(b)(1).[1] Under Rule 9(b), a plaintiff must set forth specific facts supporting an inference of fraud. *Melder v. Morris*, 27 F.3d 1097, 1102 (5th Cir. 1994). The PSLRA requires a plaintiff to "state with particularity *facts giving rise to a strong inference* that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(ii) (emphasis added).

Scienter -- a mental state embracing the intent to deceive, manipulate, or defraud -- is the required state of mind for a § 10(b) claim. *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir), *reh'g denied*, 20 F.3d 1172 (5th Cir. 1994) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)). The Fifth Circuit has interpreted the scienter element to include severe recklessness, "which, 'properly defined and adequately distinguished from mere negligence,'

---

[1] To state a claim under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, plaintiffs must allege (1) a misstatement or an omission (2) of a material fact (3) made with scienter (4) on which the plaintiff relied, and (5) that proximately caused the plaintiff's injury. *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 406-07 (5th Cir. 2001).

resembles a slightly lesser species of intentional misconduct." *See, e.g., Nathenson v. Zonagen*, 267 F.3d 400, 408 (5th Cir. 2001) (quoting *Broad v. Rockwell Intern. Corp.*, 642 F.2d 929, 961 (5th Cir. 1981)). Severe recklessness sufficient to constitute scienter is "limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Nathenson*, 267 F.3d at 408 (quoting *Broad*, 642 F.2d at 961-62).

In *Nathenson*, the Fifth Circuit announced a more stringent standard for pleading scienter under Rule 10b-5 than the motive and opportunity test adopted by the Second Circuit. The Fifth Circuit explained that the PSLRA requires that the complaint plead *facts* with *particularity* that give rise to a *strong* inference of scienter. *Nathenson*, 267 F.3d at 411. The "probative force of facts alleged ultimately depends on reason and experience," but allegations of motive and opportunity alone do not raise the necessary strong inference of scienter. *Id.* at 411-12; *see also In re BMC Software, Inc. Sec. Litig.*, 183 F. Supp. 2d 860, 901 (S.D. Tex. 2001).

A. Plaintiffs' Allegations Regarding Mr. Lay's Enron Stock Sales Do Not Give Rise to a Strong Inference of Scienter

The cornerstone of plaintiffs' allegation of scienter against Ken Lay is that he sold Enron stock during the class period. *See, e.g.*, Compl. ¶ 400-01. Plaintiffs contend that Lay was motivated to orchestrate a fraud on the securities markets by artificially inflating the price of Enron stock so that he could sell his personal holdings at a profit. *See id.*, ¶ 396. "'Insider trading, however, must be 'unusual' to have meaningful probative value." *Nathenson*, 267 F.3d at 420-21. Insider selling is "unusual" or "suspicious" only when it is calculated to maximize the personal benefit from undisclosed inside information. *See In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 986 (9th Cir.), *reh'g denied*, 195 F.3d 521 (9th Cir. 1999). Sales that are "inauspiciously timed" do not satisfy this standard. *Nathenson*, 267 F.3d at 421 (citations omitted).

1. The Declaration of Scott D. Hakala Does Not Satisfy Plaintiffs' Burden to Plead Scienter

Plaintiffs rely almost exclusively on the Declaration of Scott D. Hakala to establish scienter against Ken Lay. Based upon two statistical analyses that he describes generally -- with critical calculations, formulas, and tests omitted -- Dr. Hakala concludes, supposedly with a 99.9% level of confidence, that Lay's sales of Enron securities during the class period were "not consistent with an absence of foreknowledge regarding the future relative or absolute price declines of Enron shares." Declaration of Scott D. Hakala ("Hakala Decl.") ¶ 36. This assertion alone is insupportable based upon the gaping holes in Hakala's analysis, as more fully discussed in the motion to strike his declaration filed herewith. *See Demarco v. Depotech Corp.*, 149 F. Supp. 2d 1212, 1220-22 (S.D. Cal. 2001) (striking expert witness affidavit attached to securities fraud complaint filed by lead counsel herein). But as far as it goes, it does not say much. When the double negative is parsed, all Hakala is saying is that he is certain that Ken Lay might have sold Enron shares with knowledge that the price of the stock would go down.

But Hakala does not stop there. He goes on to assert: "Lay's shareholding behavior in 2001, and specifically between May and October 2001, was strongly consistent with, and implied, foreknowledge of future relative or absolute price declines of Enron's shares." Hakala Decl. ¶ 36. In this he commits the cardinal sin of a statistician: he confuses correlation with causation. Even if Hakala had done what he was supposed to do -- used clearly delineated methodologies acceptable to economists; laid out his data, calculation, formulae, and tests so that they could be replicated, analyzed, and tested; and determined according to statistically acceptable methodologies whether there was a correlation between sales of shares by Ken Lay and announcements resulting in declines in Enron's stock price -- he could not possibly conclude that Ken Lay knew and used material non-public information when he decided to sell shares.

There are a host of reasons why insiders sell shares, as acknowledged in the very literature cited by Hakala. *See Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001); Heath, Huddart & Lang, "Psychological Factors and Stock Option Exercise," *Quarterly Journal of Economics*, May 1999, at 602, 624-25; Huddart, "Patterns of Stock Option Exercise in the United States," Chapter 8 in *Executive Compensation and Shareholder Value*, (Carpenter & Yermach, eds.) pp. 115-142 (1998) at 118-19, 130-31 ("*Huddart*").[2] They may have liquidity needs. *Huddart*, p. 130. Margin calls may be due, or debts may need to be paid. *See, e.g., Coates v. Heartland Wireless Comm., Inc.*, 26 F. Supp. 2d 910, 919-20 (N.D. Tex. 1998); *In re MCI WorldCom, Inc. Sec. Litig.*, 191 F. Supp. 2d 778, 792-93 (S.D. Miss. 2002). They may be over-concentrated in Enron shares. *Huddart*, p. 130. They may own stock options that are about to expire. *See Greebel v. FTP Software, Inc.*, 194 F.3d 185, 206-07 (1st Cir. 1999). No statistical analysis would enable Hakala to read Ken Lay's mind and to know why he was selling shares, particularly when he states that his only knowledge about Ken Lay is derived from his previous sales of Enron stock. Hakala Decl. ¶¶ 17, 28, 31.

The Fifth Circuit reported recently that a statistician was embarrassed when he had to admit to making the same critical error as Dr. Hakala. In *Munoz v. Orr*, 200 F.3d 291, 301 (5th Cir.), *cert.*

---

[2] Copies of these publications are included in the appendix submitted with this brief ("Lay App." or "Lay Appendix") at tabs 5 and 6, respectively.

denied, 531 U.S. 812 (2000), another doctor tried to testify in support of other plaintiffs attempting to show employment discrimination. The doctor there "stated the discrimination was the 'cause' of the disparities he had observed, a statement which he later recanted as 'overzealous' since statistics can show only correlation and not causation." *Id.*

What is even more glaring about Hakala's overzealous assertion of causation is that he ignores contentions made by plaintiffs in this very case that Ken Lay faced a liquidity crisis as the price of Enron shares plummeted. Seeking to obtain discovery supporting their motion for an asset freeze, plaintiffs have submitted to this Court a number of articles to support their contention that Ken Lay had liquidity problems.[3] *See* Second Supplemental Brief in Response to the Court's January 8, 2002 Memorandum and Order Concerning Particularized Discovery ("Second Supplemental Brief") (Docket # 251). *See also* Starro Asset Management, LLC's Brief in Support of Amalgamated Bank's Pending Motion to Depose Kenneth Lay Regarding Dissipation and Concealment of Assets (Docket #235). Thus, Hakala's conclusion about the cause of Ken Lay's stock sales is not only irresponsible as a matter of statistical principles, it fails to take into account a perfectly logical explanation for sales in the fall of 2001 that plaintiffs' own counsel has presented to this Court.

Hakala's methodologies are not recognized by any legal authorities as demonstrating the kind of unusual trading behavior that might raise a strong inference of scienter. Hakala does not use the methodologies recognized by court authority for a good reason. If he did, they would show that Ken Lay's trading activity was *not* unusual and, indeed, that it was *inconsistent* with any assumption that Ken Lay somehow participated in a scheme to inflate the value of Enron stock so that he could

---

[3] The Court may consider previous pleadings filed in this action on a motion to dismiss. *See Demarco v. Depotech Corp.*, 149 F. Supp. 2d 1212, 1217-18 (S.D. Cal. 2001).

personally capitalize on the inflated value by selling his own shares. As demonstrated below in section II(A)(2), if Ken Lay was an insider trader, he did a very poor job of it.

Even if Hakala's unorthodox approach to determining unusual trading behavior were accepted, upon closer review of the actual information filed with the SEC concerning Ken Lay's sales of Enron shares, these approaches actually demonstrate that Ken Lay did *not* engage in insider trading.

One of Hakala's approaches is to examine the circumstances under which Enron executives such as Ken Lay exercised employee stock options. Hakala notes that decisions by executives to exercise stock options for too little profit (the difference between the exercise price of the option and the stock's trading price at the time of exercise, known as its "intrinsic value" or the amount by which the option is "in the money") are unusual if they should wait longer in hopes that the profit from exercising the options will be greater at a later date. Hakala Decl. ¶¶ 20, 25. He describes this behavior in general as the premature exercise of employee stock options, and purports to have found a formula based upon the value of the stock options to measure premature exercise. Hakala Decl. ¶¶ 9, 25, 28, 34. As discussed more fully in the motion to strike his declaration, Hakala does not provide enough information to determine how he constructs and uses his formula, and the literature he relies upon does not recognize his methodology as valid in the way he attempts to use it.

One critical flaw in this approach is that the decision by an executive to exercise stock options is driven by a wide variety of factors unique to each executive. Executives, like all investors, will have different risk tolerances and liquidity needs as their financial circumstances vary. An executive approaching retirement, with virtually his entire wealth tied up in Enron stock and needing to meet significant financial commitments, will be much more willing to exercise stock options early to avoid the risk that the price of the stock will fall and never recover, or that the options may expire worthless. On the other hand, a younger executive at the outset of her career, without her wealth tied up in Enron stock, may be willing to defer exercise of stock options until much closer to the expiration date in hopes that the price of the stock would continue to climb (in spite of the risk that, if the price fell, the options could expire worthless).

Just as the risk tolerance and investment needs of a typical investor are not static, but change as their financial circumstances change, the factors influencing an executive's decision to exercise options will change as the executive's financial circumstances change. Thus, Hakala makes another critical error in analyzing Mr. Lay's option exercises, by assuming that over a three-year period (during which Lay, at age 58, stepped down as Chief Executive Officer), the factors influencing Ken Lay's decisions to exercise options never changed.

Notwithstanding the flaws in his analysis, Hakala actually finds nothing unusual about Lay's decisions to exercise options for over two-thirds of the class period, through the end of 2000. Hakala Decl. ¶ 30. In criticizing Lay's decisions to exercise options in 2001, Hakala focuses most of his fire on the option exercise by Ken Lay on August 20, 2001. He writes:

> On August 20, 2001, Lay prematurely exercised 25,000 options at $20.78 per share at a time when the share price of Enron was $36.25. These options would not expire until December 31, 2004. The premature exercise of these options was economically inconsistent with Lay's prior economic behavior and inconsistent with rational economic behavior absent a belief that Enron's shares would decline in absolute or relative value (in comparison with a diversified investment in equity securities) in the future.

Hakala Decl. ¶ 34.

What Hakala omits to advise the Court (or simply missed) is that Ken Lay exercised these 25,000 options on August 20, 2001 not to *sell* the stock, but to *hold* Enron stock.[4] This exercise, for the account of the Lay family partnership, cost $519,532.50. In addition, the difference between the exercise price and the share price at the time of exercise was taxable at ordinary income rates, regardless of whether the price of the stock fell after it was acquired. *See* 26 C.F.R. § 1.83-7, *Taxation of Nonqualified Stock Options*; John L. Utz, 383 - 3rd Tax Mgm't, *Nonstatutory Stock Options*, p. A-18 ("Utz"). Contrary to the inference Hakala would draw, it would have been the height of folly for Ken Lay to have paid $519,532.50 and to incur a tax liability to exercise these options and to hold these shares if he expected the shares to decline in value. On the other hand, Ken Lay's decision to exercise these options and to hold the shares is consistent with an expectation that the price of Enron shares would appreciate in value.[5]

Hakala's failure to recognize the fundamental difference between an exercise of options to sell stock and an exercise of options to hold stock casts severe doubt on his entire analysis. He also fails to advise the Court that on August 21, 2001, Ken Lay for his own account exercised 68,620 Enron stock options expiring on December 31, 2001, also to hold the stock. He paid $1,479,618.75 to exercise these options. Ken Lay's decision on August 20 and 21, 2001, to pay $2 million to

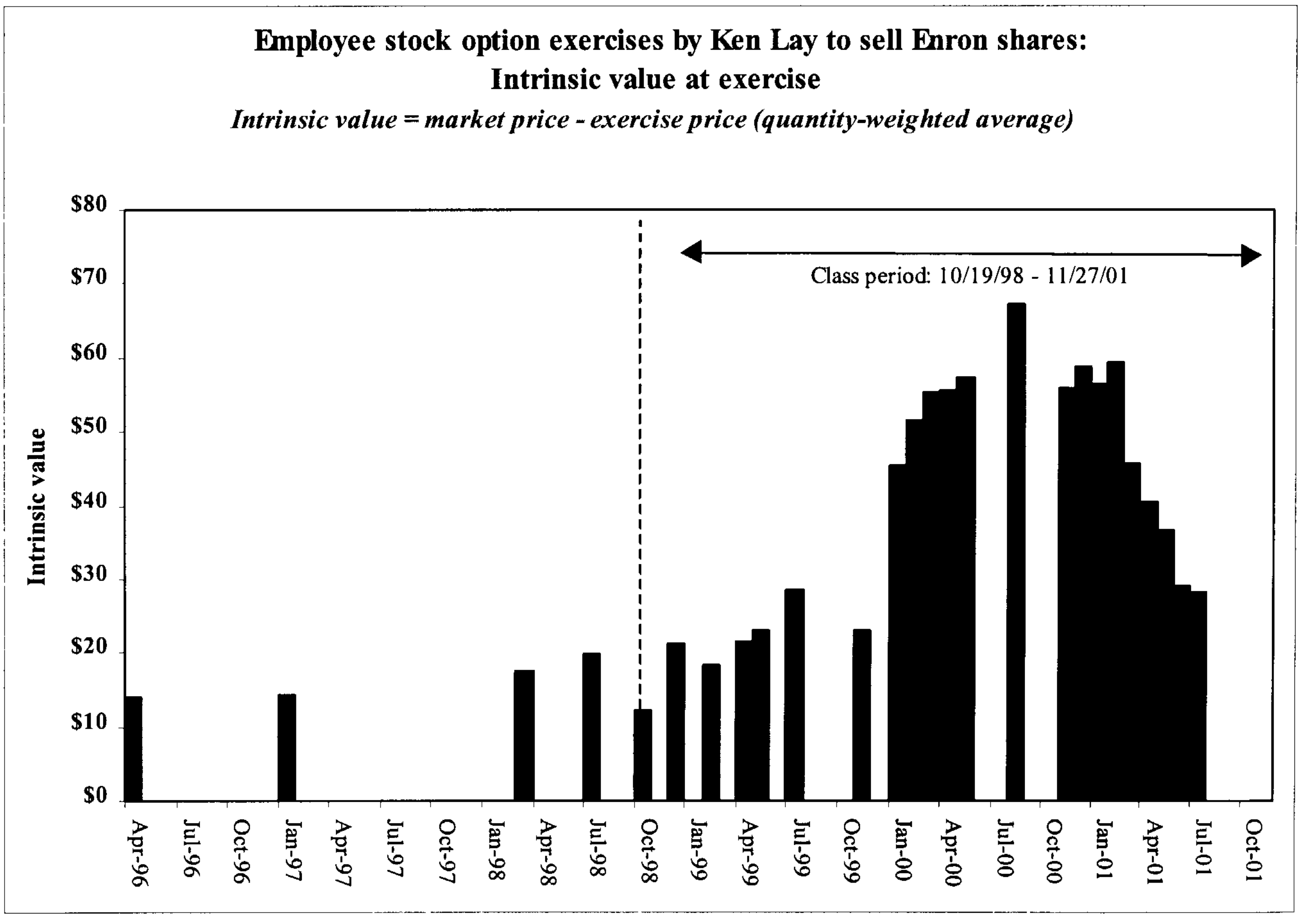
---

[4] The Form 4 reporting this transaction is attached as tab 1 to the Lay Appendix.

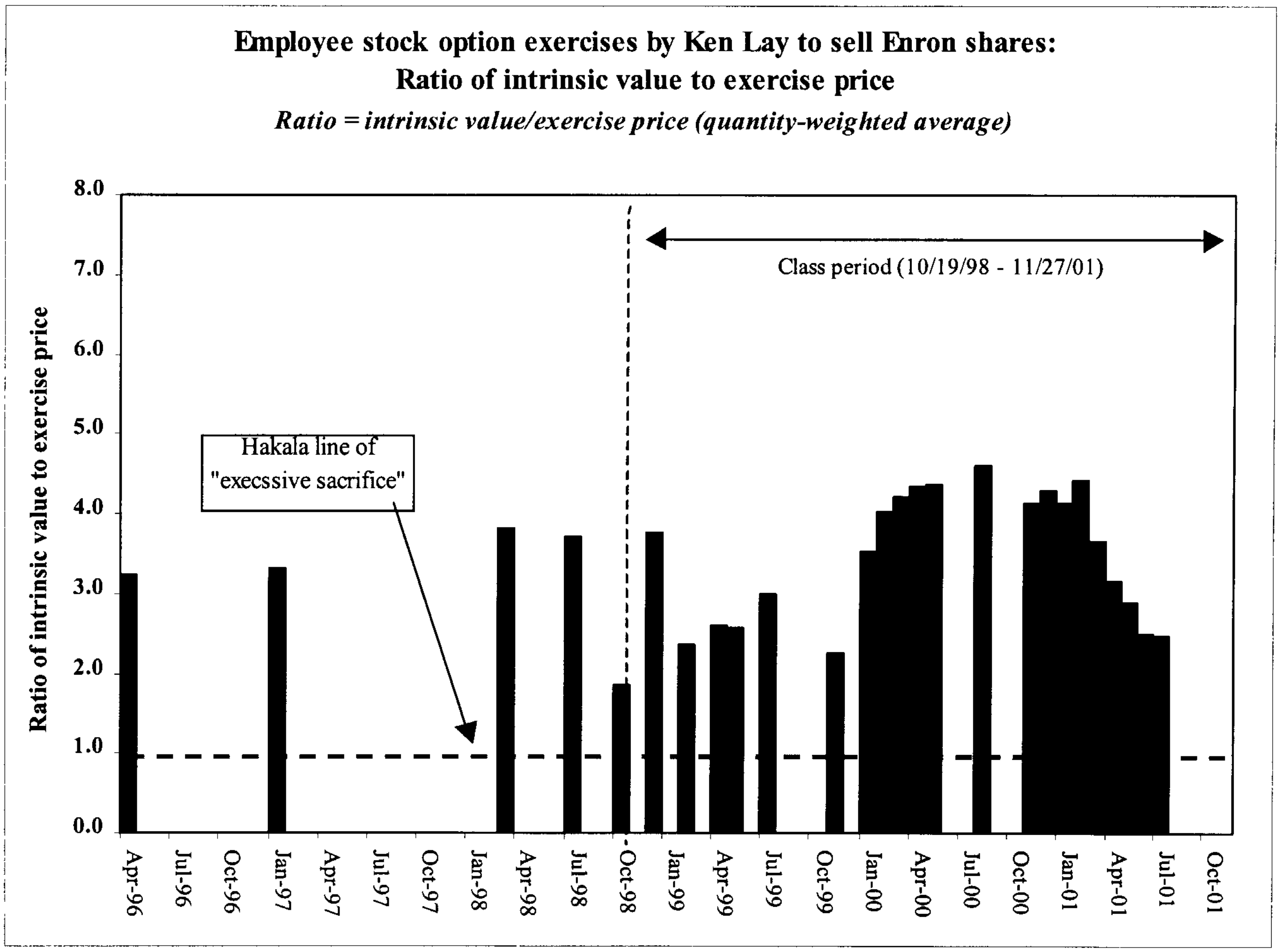
[5] Ken Lay would pay taxes at the long-term capital gain rate on the stock's appreciation after exercise, measured by the difference between the price at which he eventually sold the stock and its market price at the time of exercise ($36.25, according to Hakala's Declaration). *See Utz*, *supra*, at p. A-18. If he had chosen instead to exercise the same options later after the stock had appreciated substantially in value, he would have had to pay taxes at the ordinary income rate on the difference between the exercise price and the market price, instead of the long-term capital rate. *Id.* Thus, Ken Lay's decision was perfectly consistent with rational economic behavior designed to maximize gains and minimize tax liability, assuming that he had a belief that Enron shares would *increase*, not decline, in value in the future.

acquire 93,620 shares, in addition to assuming additional tax liability, makes no economic sense if he believed, as plaintiffs allege, that Enron was a "house of cards" about to collapse.

Another major premise advanced by Hakala for his conclusion that Ken Lay traded on improper inside information is that Mr. Lay's option exercising behavior changed. The information about Ken Lay's option exercises in his SEC filings demonstrates that during the class period Ken Lay, on average, exercised options that were *more* "in the money" than the options he exercised before the class period, contrary to the pattern Hakala posits for an insider trader:



Hakala identified when he considered premature option exercises to be "unusual": "option exercises where the individual sacrificed excessive value (exercised stock options more than six months prior to expiration and where the exercise price was greater than 50% of the current stock price of Enron)." Hakala Decl. ¶ 25. An exercise price of 50% of the current stock price translates into a ratio of the dollar amount that the option is "in the money" (its "intrinsic value") to the exercise price of 1:1. Thus, according to Hakala, the exercise of stock options when the ratio of intrinsic value to exercise price is *below* one represents "excessive sacrifice." The following graph demonstrates that Ken Lay's option exercises were *above* the Hakala "excessive sacrifice" line:



Hakala asserts elsewhere in his declaration that he "generally found premature exercise of a vested option was only possible in a rational model of economic behavior for a relatively undiversified, significantly risk-adverse executive when the stock price was at least three to four times greater than the exercise price." Hakala Decl., ¶ 13 n.21. This translates into an intrinsic value to exercise ratio ranging from 2:1 to 3:1. A review of the chart above shows that Lay's stock option exercises during the class period fall within this range or higher, once again demonstrating that Lay's exercises were not unusual according to Hakala's own formula.[6]

Plaintiffs use yet another ratio in their consolidated complaint, contending that any premature exercise is unusual if it falls below a ratio of intrinsic value to exercise price of 3:1. *See* Compl. ¶ 408 (market price must be at least four (4) times the exercise price). This general assertion of opinion, contradicted by plaintiffs' own expert, is not a statement of specific fact on which this Court may rely in determining whether plaintiffs have pled a strong inference of scienter.[7]

---

[6] Only one scholarly, peer-tested work, among the publications cited by Hakala (or referenced therein), analyzes the range of in the money values at which executives typically exercise stock options. Hall & Murphy, "Stock Options for Undiversified Executives," *Journal of Accounting & Economics*, 33 (2002) 3-42 at pp. 29-33. *See* Lay App., at tab 4. Hakala cites to a practitioner-oriented article summarizing this scholarly work at footnote 19 of his Declaration. Hall and Murphy, "Option Value Does Not Equal Option Cost," *World at Work Journal*, pp. 23-27, 2d Qtr. 2001. *See* Lay App., tab 3. The authors of this study emphasize that *where* executives exercise options within the general range will depend upon variables unique to the executive, including their risk aversion and their degree of concentration in the stock. Nevertheless, the intrinsic value to exercise ratio generally falls within a range of 0.5:1 to 2:1, well below the range that Hakala uses. *Id.* at 31, fig. 7. Review of the chart above shows that Lay's exercises are at ratios of 0.5:1 or 2:1 or greater, and are therefore consistent with the expected behavior of executives.

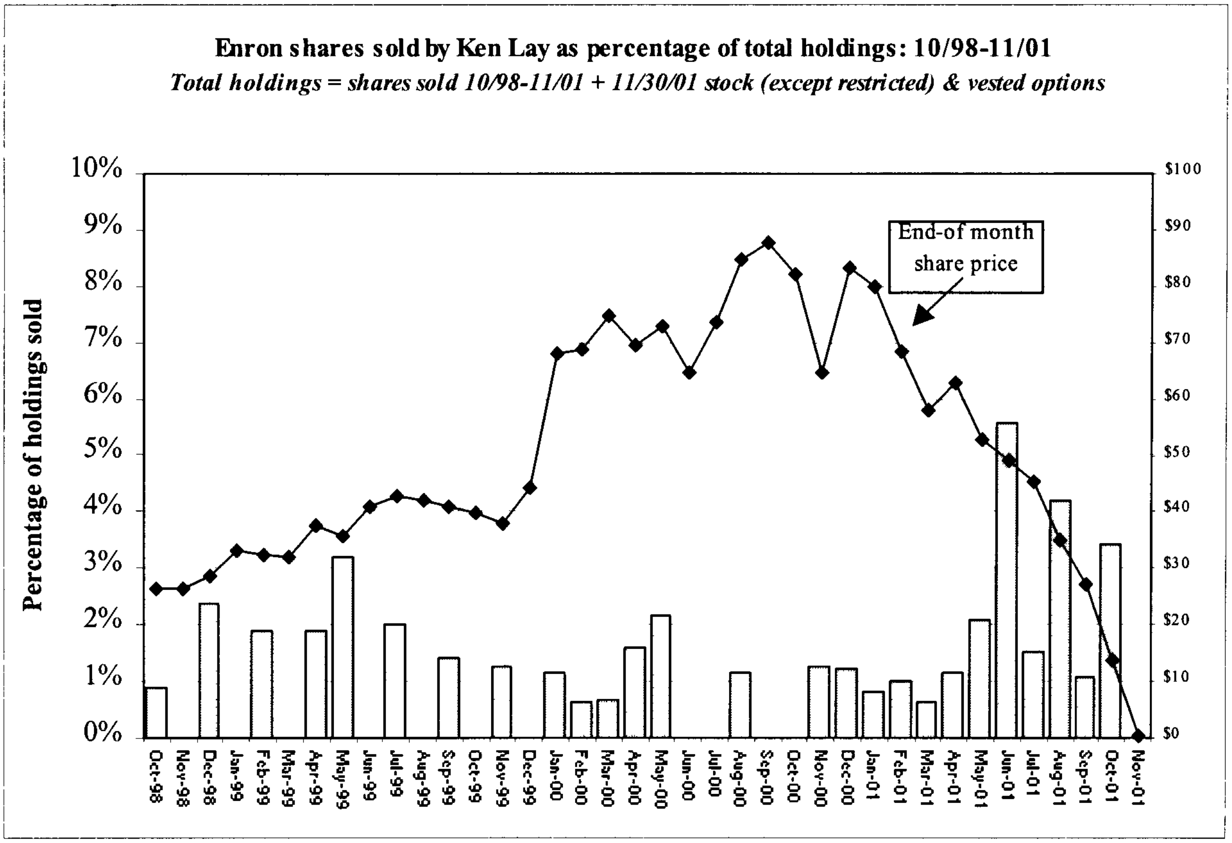
[7] Plaintiffs also allege in the text of the complaint: "In particular, as the Hakala Decl. details, many of the option exercises by Lay, Skilling, Pai and Rice exceed the 10% risk premium limitation which rationally bounds the limits of even a very risk-adverse, liquidity constrained executive." Compl. ¶ 413. In fact the Hakala declaration does not provide detail for any of these propositions, including the methodology and calculations for the application of the alleged risk premium analysis to option exercises by particular plaintiffs. As to Lay, Hakala provides *only one example* of where Lay's exercise allegedly exceeded this risk premium limit, and that was the August 20, 2001, exercise by Lay to acquire *and hold* 25,000 shares, discussed above. Hakala Decl. ¶ 34. Thus, this unsubstantiated assertion of opinion in the complaint about Lay's option exercises should (continued...)

The other approach that Hakala takes to analyzing Lay's stock trades is to conduct a statistical analysis that supposedly correlates the timing of his sales with announcements by the company that resulted in drops in the price of Enron stock supposedly not explainable by market or industry factors. Hakala Decl. ¶ 35. Hakala claims to have conducted an event study of sorts, but does not provide enough information to determine whether the event study conforms with accepted methodologies. It is a complete mystery how he then uses that event study to correlate with Lay's sales of Enron shares, because he provides few, if any, clues about the calculations, methodology, and tests he conducted to make the statistical analysis. His conclusion that Lay traded based on inside information is therefore nothing more than an "*ipse dixit*" that this Court must ignore. *General Electric Co. v. Joiner*, 522 U.S. 136, 144-46 (1997). Hakala's conclusion also suffers from the fatal flaw, discussed above, that it confuses correlation with causation.

Once again, when the Court actually studies the specific facts concerning Ken Lay's sales of Enron shares -- instead of the unsubstantiated, and incapable of being substantiated, opinion of Hakala -- a completely different picture emerges. The chart below compares Ken Lay's stock sales during the class period (as a percentage of Enron stock that he could have sold) with Enron's stock price:

---

[7] (...continued)
likewise be disregarded by the Court in determining whether plaintiffs have alleged particular facts raising a strong inference of scienter.



This graph demonstrates that Ken Lay's sales of Enron stock were lowest when the stock was at its highest prices. As discussed below, courts have interpreted this pattern as indicating the absence of insider trading. When the objective facts shown in the SEC filings about Ken Lay's trading are examined, this Court can only reasonably conclude that plaintiffs have failed to plead specific facts demonstrating that Ken Lay's trading was unusual or suspicious in ways that evidenced improper insider trading.

2. When Analyzed Carefully, Rather Than Superficially, Mr. Lay's Stock Sales Are Not "Unusual" or "Suspicious"

In addition to Hakala's declaration, plaintiffs rely on a very superficial analysis of Mr. Lay's sales, placing great importance on their contention that Mr. Lay sold 4,002,259 shares of stock during the extraordinarily long, three-year class period, for $184,494,426 in proceeds. *See, e.g.,* Compl.

¶ 401. As a Texas federal court judge once explained, "[t]his may be a compelling argument until one reviews *what actually happened*." *Thornton*, 878 F. Supp. at 937 (emphasis in original). A careful review of *what actually happened* in connection with Mr. Lay's stock sales during the class period discloses that his trades are neither "suspicious" nor "unusual."

a. Mr. Lay's 10b5-1 Sales and Exercises of Expiring Options Do Not Raise a Strong Inference of Scienter

During the class period Lay sold 657,109 Enron shares -- or 6.22% of the Enron stock and vested options available for sale during the class period -- pursuant to a 10b5-1 selling program.[8] In

---

[8] The table attached as Exhibit 1 hereto is a summary of combined sales of Enron shares by Ken Lay for his personal account and for the Lay family partnership during the alleged class period. The information in the summary, as well as all of the charts and graphs included in this brief, are based upon published Enron stock price information and information contained in filings with the SEC, including Forms 4 and 5 and Enron's proxy statements, for the relevant time frame. Copies of the Forms 4 and 5 filings and the stock price information are included in the Lay Appendix at tab 1, and copies of the proxy statements filed by Enron for 1996-2001 are included in the Master SEC Appendix ("Master SEC App.") filed with the Joint Brief at tabs 20-22 and 86-88.

The sales shown in the table attached as Exhibit 1 hereto are placed into three categories: (1) cashless exercises; (2) loan repayments for 2001; and (3) other sales. In a cashless exercise, Mr. Lay would instruct his broker to sell in the open market the number of shares he was entitled to exercise pursuant to a vested stock option granted to him by Enron. The exercise price would be paid from the proceeds of the sales, and Mr. Lay would receive the difference between the gross proceeds from the sale of the shares and the proceeds used to pay the exercise price. He would then have to pay taxes on the net proceeds at the ordinary income rate. *See Utz, supra*, at p. A-18. Within the tenth day of the month after a cashless exercise, Mr. Lay was required to file a Form 4 with the SEC describing the cashless exercise. Section 16(a) of the Exchange Act; 17 C.F.R. § 240.169-4.

During 2001, Mr. Lay also transferred shares to Enron itself in repayment of a revolving credit loan that Enron had provided to Mr. Lay as part of his compensation. This loan is described in the 2001 Proxy Statement filed by Enron at page 24. *See* Master SEC App., tab 22. Mr. Lay was required to file with the SEC a Form 5 describing these loan repayment transactions within 45 days after the end of the fiscal year in which they were done. SEC 16a-3(f); 17 C.F.R. §240.169-3(f). Thus, the sale transactions shown on the Form 5 that he filed on February 15, 2002, are loan repayments. The Form 5s do not reflect the cost of the shares delivered to Enron.

(continued...)

2000, the Securities and Exchange Commission adopted Rule 10b5-1, which provides a defense against allegations of insider trading when insiders sell stock pursuant to a 10b5-1 trading plan directing the sale of a pre-established number of shares or options at pre-determined times. *See* 17 C.F.R. § 240.10b5-1. The new trading rules went into effect on October 23, 2000. *See* 53 S.E.C. Docket Release No. 7881, *Selective Disclosure and Insider Trading*, 2000 WL 1201556 (Aug. 15, 2000).

Beginning on November 1, 2000, Mr. Lay's Form 4 filings reflect that he sold 3,534 shares of Enron stock in his personal account and 500 shares in his family partnership account each trading day pursuant to 10b5-1 Sales Plans.[9] Exhibit E to the Hakala Declaration also reflects these daily

---

[8] (...continued)
The third category of "other sales" includes sales of shares that Mr. Lay held from previous stock option exercises and any other sales transactions described in Form 4 filings that were not cashless exercises. The Form 4 filings also do not show cost information for these transactions.

The cashless exercises are divided in subcategories so that the Court can determine how many shares were sold pursuant to Rule 10b5-1 selling programs and how many shares were sold pursuant to options that were expiring during the class period. Since some of the program sales were pursuant to the exercise of options expiring during the class period, the program sales are divided into "expiring options used in program sales" and "program sales other than expiring options."

To be consistent, all of the charts presented herein use gross sales proceeds because cost data is not filed with the SEC for all sales. Plaintiffs' analysis improperly mixes net sales proceeds and gross sales proceeds, and artificially adjusts the number of shares sold.

The "holdings" used to calculate the percentage of shares sold out of all shares that could have been sold in the class period include the total of all class period sales and Lay's holdings of stock, other than restricted stock, and vested options as of November 30, 2001, at the end of the class period.

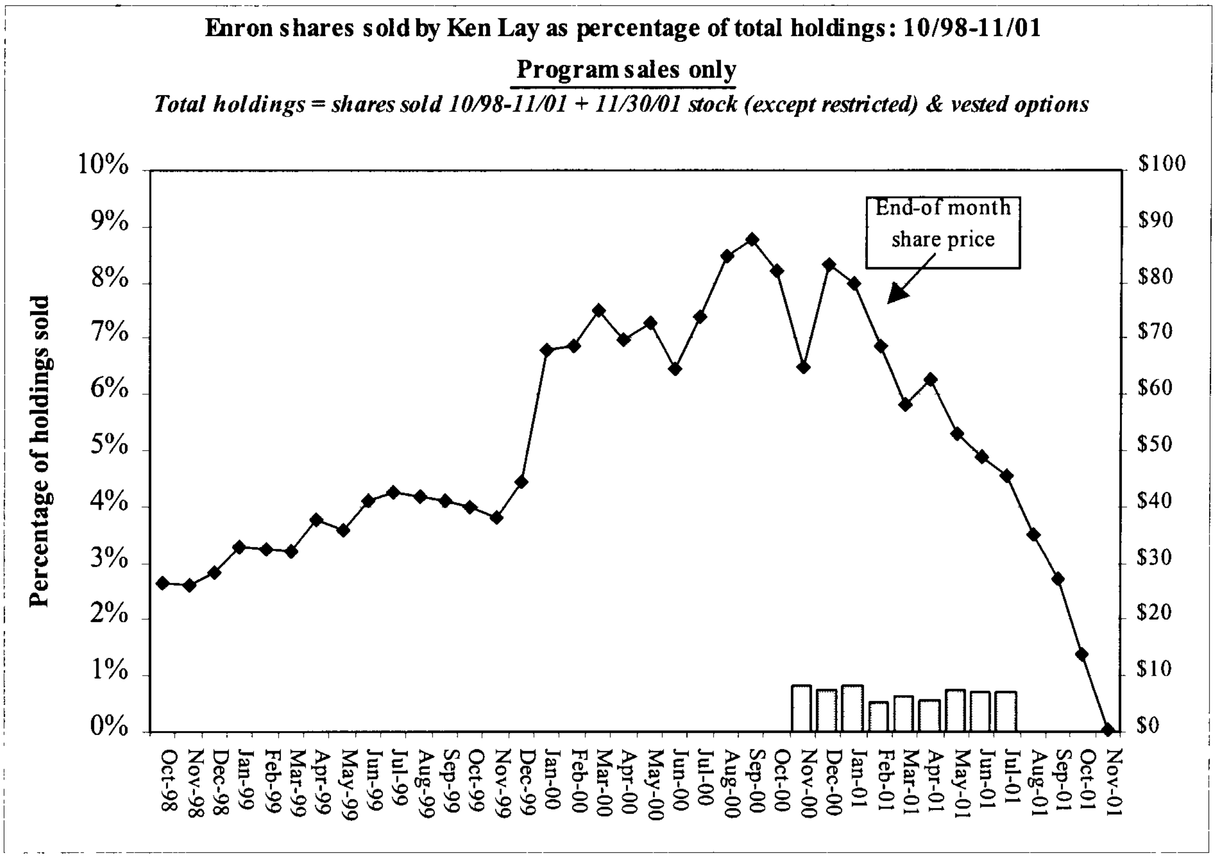
[9] The plaintiffs' complaint refers to the Enron defendants' Rule 10b5-1 plans and confirms that some of the insider sales were undertaken pursuant to such plans. *See* Compl. ¶ 405; *see also* Hakala Decl. ¶ 32 n.31 ("Lay began exercising options and selling shares almost daily with the establishment of 10b5-1 plans in the fall of 2000.") The Form 4 filings for November 2000 (continued...)

sales (beginning on page 5 of 21). This exhibit also reflects that on February 1, 2001, Mr. Lay modified his 10b5-1 program to change the amount of stock to be sold each trading day in his personal account to 2,500 shares per day. *See* Hakala Decl., Exhibit E, p. 10. At the beginning of May 2001, Mr. Lay also revised his Sales Plan for the family partnership account to increase the number of shares sold to 1,000 per day. *See id.*, p. 15. These sales continued until July 31, 2001, when Mr. Lay cancelled both Sales Plans, after the price of Enron stock had fallen to $45.35 per share. *See id.*, p. 21. Neither the timing of these sales -- following closely the adoption of Rule 10b5-1 -- nor the amount can raise any suspicion.[10] As reflected on the chart below, these sales were a modest percentage of Ken Lay's total holdings:

---

[9] (...continued)
through July 2001 expressly refer to the sales pursuant to the 10b5-1 plans. The information disclosed in the Form 4 filings comport generally with information about Mr. Lay's trading reflected in Exhibit E to the Hakala Declaration, which indicates that on November 1, 2000, Mr. Lay began a program of selling daily 3,534 shares for one of his accounts and 500 shares for another account.

[10] Plaintiffs claim that the insider stock sales pursuant to 10b5-1 selling programs are not protected by Rule 10b5-1 because at the time the programs were adopted "those individuals were already in the midst of pursuing the fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of Enron securities." *See* Compl. ¶ 405. Plaintiffs' conclusory allegation in this regard should be ignored by the Court. *Tuchman*, 14 F.3d at 1067-68; *In re Azurix Corp. Sec. Litig.*, No. H-00-4034, 2002 WL 562819, at *9 (S.D. Tex. Mar. 21, 2002) ("[C]onclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to prevent a motion to dismiss.") (citations and quotations omitted).



Mr. Lay sold 1,079,601 shares, or 10.33% of the shares he could have sold during the class period, pursuant to options that were scheduled to expire during the class period. Each of these sales was a "cashless exercise," meaning that Lay exercised the options and sold the shares simultaneously, receiving the difference between the sales price for the shares and the exercise price. Stock sales such as these that are caused by a need to take action before a deadline negate an inference of scienter. *See, e.g., Greebel*, 194 F.3d at 206-07 (sale of more than $20 million worth of stock by a departing officer failed to establish an inference of scienter because an individual leaving a company often has a limited period of time to exercise her stock options); *Gaylinn v. 3Com Corp.*, No. C-99-2185, 2000 WL 33598337, at *12 (N.D. Cal. June 9, 2000) (sale of 100% of stock by corporate insider held insufficient to establish scienter because he sold most of his stock after he left the company and under his executive stock option plan, he had to exercise his stock options within 90 days of his departure or forfeit them).

Setting aside Mr. Lay's 10b5-1 sales and sales prompted by expiring options, Mr. Lay's remaining sales during the class period account for 31.9% of his Enron holdings.[11] These sales do not raise a strong inference of scienter, particularly when the Court considers the extraordinarily long, three year class period alleged by plaintiffs. The Ninth Circuit, for example, held that officers' sales of 26%, 32%, 48%, 49%, and 55% of their holdings over a 15-month class period were insufficient to raise a strong inference of scienter. *See In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1094-96 (9th Cir. 2002). The *Vantive* court described the distorting effect of an unusually long class period on an analysis of insider sales:

> Before we examine the individual defendants' sales, we point out some overarching considerations. First, the plaintiffs have selected an *unusually long class period of sixty-three weeks*. . . . [L]engthening the class period has allowed the plaintiffs to sweep as many stock sales into their totals as possible, thereby making the stock sales appear more suspicious than they would be with a shorter class period.

Vantive, 283 F.3d at 1092 (citations omitted) (emphasis added). The court held that "[i]t is not inherently alarming or unusual that an insider might sell a quarter of his holdings over the course of *fifteen months*, particularly in a volatile industry." *Vantive*, 283 F.3d at 1094 (emphasis added); *see also In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C 99-00109, 2000 WL 1727377, at *23 (N.D. Cal. Sept. 29 2000) (identifying the fact that the class period extended over 90 weeks as a "major

---

11 As the chart at Exhibit 1 demonstrates, 10b5-1 program sales and expiring option sales together account for 1,512,610 shares, or 14.33% of the shares Mr. Lay could have sold in the class period. Lay sold 46.24% of the shares he could have sold during the class period (consisting of all shares sold plus the shares (other than restricted stock) and vested options outstanding as of November 30, 2001, at the end of the class period). Thus, the remaining sales during the class period, including the loan repayments, consisted of 31.9% of the available shares.

mitigating factor" in determining whether an officer's sale of 31.32% of her holdings during the class period was suspicious).[12] Extending the analysis of *Vantive* to the facts before this Court, it is not "unusual" or inherently suspicious that Mr. Lay sold by any analysis between a third and a half of his holdings over a three year -- or *36 month* -- period.

While the total dollar amount in gross proceeds from Mr. Lay's sales during the class period is certainly substantial, it also does not qualify as "unusual" or "suspicious" for purposes of a scienter analysis in view of the three-year class period. In *In re VISX, Inc. Sec. Litig.*, Nos. C-00-0649, C-00-0815, 2001 WL 210481, at *8 (N.D. Cal. Feb. 27, 2001), for example, the court held that a CEO's sale of 730,000 shares generating proceeds of $51.8 million over a 50-week class period was not sufficiently suspicious to raise an inference of scienter. The class period in this case is more than three times longer than the class period in *VISX*.

Moreover, when the timing of Mr. Lay's sales and his total holdings are properly considered, his investment activity paints a picture of a CEO who, throughout the class period, believed that Enron was a good investment and acted accordingly. In other words, Ken Lay's actions during the class period affirmatively negate any reasonable inference of scienter.

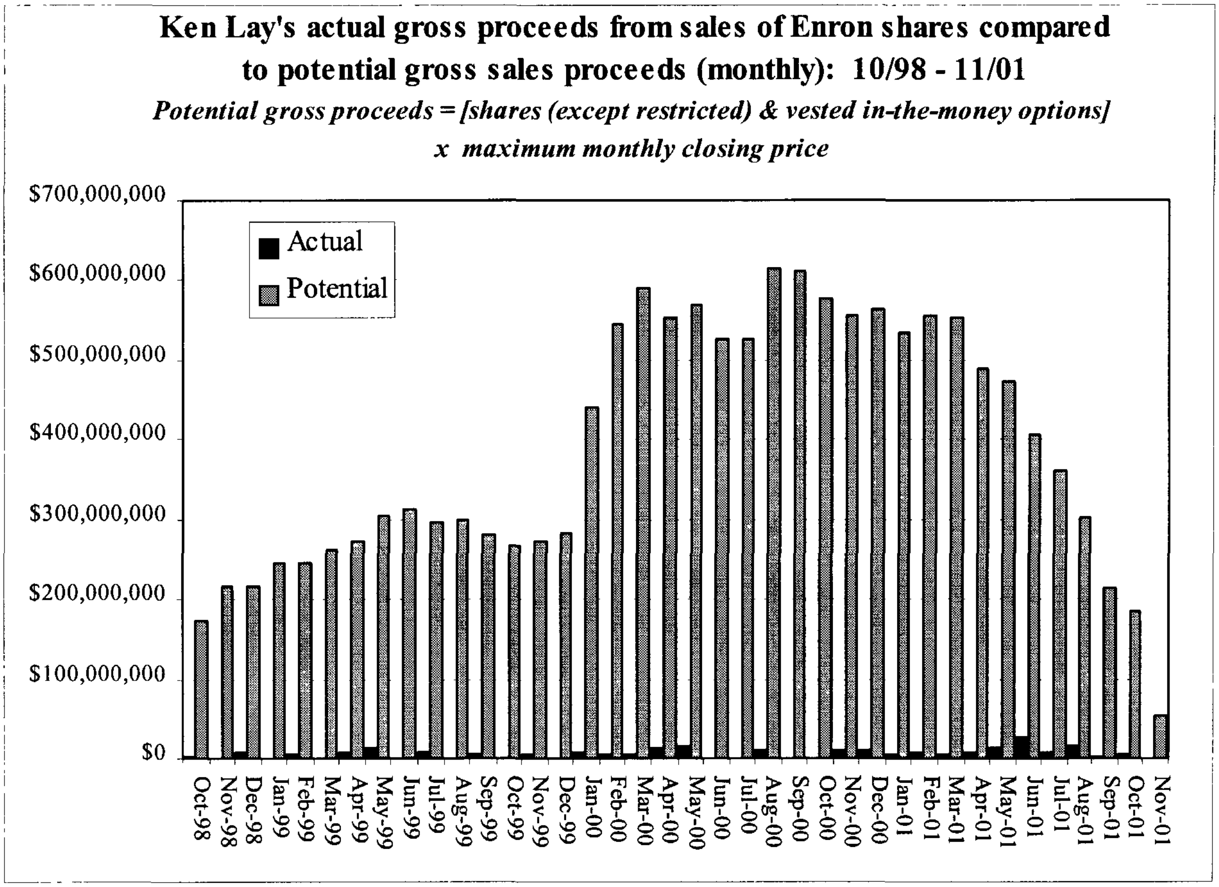
b. The Proceeds Ken Lay Actually Received from His Sales of Enron Shares Are Dwarfed by the Potential Value of Enron Holdings That He Lost During the Class Period

By retaining his huge position in Enron stock and vested options throughout the class period, Mr. Lay lost hundreds of millions of dollars. Attached as Exhibit 2 is a table entitled "Potential Gross Proceeds Compared to Actual Gross Proceeds from Sale of Enron Stock by Ken Lay in Class

[12] The unusually long class period at issue in this litigation also makes any comparison of sales during the class period to sales before the class period meaningless. *See Vantive*, 283 F.3d at 1092-94.

Period." This table tracks on a monthly basis the cumulative dollar amount of gross proceeds that Mr. Lay could have realized if he had sold all of his unrestricted stock and vested options at the maximum daily closing price for that month. The highest amount of gross proceeds that Mr. Lay could have achieved was $725,899,189 from the sale of 6,836,422 shares owned and in vested options at the high price of the month of $89.63 in September 2000. By the end of the class period, Mr. Lay had actually achieved gross proceeds from sales of Enron stock and the exercise of vested options in the amount of $234,139,766 or 32.26% of what he potentially could have realized. If Mr. Lay were motivated to inflate Enron's share price for personal gain, as plaintiffs would have this Court believe, it does not make sense that he would have foregone the opportunity to realize *nearly one-half billion dollars* in potential proceeds.

The following chart also graphically illustrates, on a monthly basis, the amount of gross proceeds from actual sales of Enron shares by Lay compared with the potential gross proceeds he could have realized:



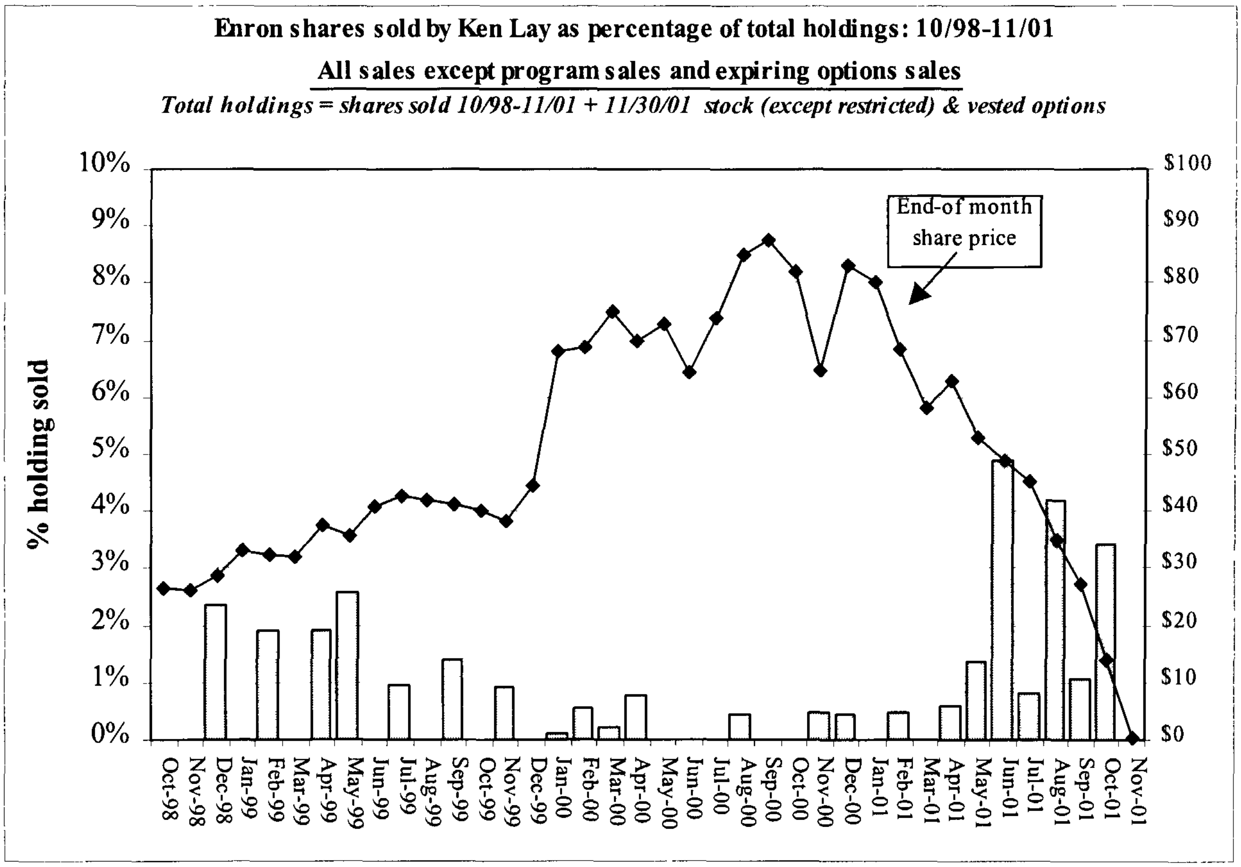
When an officer suffers more financial loss than gain, any inference of scienter is defeated. *See Chan v. Orthologic Corp.*, No. CIV 96-1514, 1998 WL 1018624, at *12 (D. Ariz. Feb. 5, 1998) ("[M]any of the individuals who had large holdings in the company and sold stock during the period in question retained more shares than they sold. Accordingly, these individuals suffered greater financial losses than gains."); *see also In re PETsMART, Inc. Sec. Litig.*, 61 F. Supp. 2d 982, 1000 (D. Ariz. 1999). The fact that Lay lost nearly $500 million in potential gross proceeds indisputably negates any inference that he engaged in a scheme to artificially increase the price of Enron stock so that he could "dump" his shares at the high, before the alleged fraud was exposed and the price of Enron shares tumbled.

c. Ken Lay's June, July, and August 2001 Option Exercises Defeat a Presumption of Scienter Because They Reflect A Belief That Enron Stock Would Not Decline in Value

In June, July, and August 2001, Ken Lay paid $4,635,873.75 to exercise options *to acquire and hold* 218,620 shares of Enron stock. *See* Forms 4 at Lay Appendix, tab 1. These option exercises also negate any inference that Lay "knew" Enron was headed for financial disaster. If, in fact, Lay knew (based on his purported inside information) that the price of Enron stock would decline because the alleged fraud would eventually unravel, he would have exercised those options and immediately sold these shares in a cashless exercise. Mr. Lay's retention of these shares -- at a cost of $4,638,873.75 plus taxes -- is consistent with an expectation that the stock would not decline, and defeats any inference of scienter. *See In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 541 (3d Cir. 1999); *In re Party City Sec. Litig.*, 147 F. Supp. 2d 282, 313 (D.N.J. 2001) (large retained holdings rebut an inference of motive even where some defendants have sold significant percentages). *See also Kurtzman v. Compaq Computers Corp.*, Civ. Action No. H-99-779, slip op. at p. 50 (S.D. Tex. April 1, 2002) ("Defendants have also shown that plaintiffs have failed to take into account the large number of options (4000 shares) that [the CFO] exercised and purchased, but did not sell during the Class Period.").

d. Ken Lay Sold His Stock at Prices Significantly Lower Than the Stock's High Price During the Class Period

Plaintiffs claim that the insider selling "escalated massively" as Enron stock moved to more inflated levels during the class period. Compl. ¶ 403. To the contrary, Ken Lay's selling *de-escalated* as Enron's stock price increased during the class period, and only increased when the stock price *decreased*. Most of Mr. Lay's stock sales during the class period occurred before the price of Enron stock started its significant advance in December 1999 and after it started to decline around April 2001. *See* chart at page 15 above. This pattern is even more pronounced when Lay's 10b5-1 program sales and the sales he made pursuant to options expiring in the class period are excluded, as shown below:



The average price at which Mr. Lay sold stock during the class period was $47.99, approximately half of Enron's trading high of $90 per share. *See* Table at Exhibit 3. Such inartful insider selling does not establish scienter. *See Nathenson*, 267 F.3d at 420-21 (insider sales at half the price to which plaintiffs allege defendants inflated the market based on misrepresentations are so inauspiciously timed that they do not establish an inference of scienter).

Insider sales that occur before a price advance do not support an inference of scienter because they are not calculated to maximize the personal benefit an insider could obtain from undisclosed inside information. *See Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001). In *Ronconi*, insiders sold stock at prices in the $50 range several months before the stock reached its high point of $73 per share. *Id.* The court concluded that "[w]hen insiders miss the boat this dramatically, their sales do not support an inference of scienter" because such sales do not indicate that insiders were dumping shares they knew were artificially inflated. *Id.* at 435. *See also Plevy v. Haggerty*, 38 F. Supp. 2d 816, 835 (C.D. Cal. 1998) (insider sales at prices from the high teens to the mid thirties were far lower than the stock's ultimate high of $53 1/4 and did not give rise to a strong inference of scienter).

Similarly, sales of stock that occur *after* the company's stock price has declined in value do not support an inference of scienter.

> Why would the defendants expend so much time and effort to conceal facts and misrepresent information to a host of securities analysts, successfully orchestrating the artificial inflation of [the company's] stock to $32 a share, and then sit back *while the stock slides daily for seven weeks to half that price* to begin enjoying the fruits of their fraud by selling their stock?

Thornton v. Micrografx, 878 F. Supp. 931, 938 (N.D. Tex. 1995). This is particularly true of Mr. Lay's sales after October 16, 2001, when Enron reported its third quarter results and announced it was taking a $1.01 billion charge to income and reducing shareholder equity by $1.2 billion. *See* Compl. ¶¶ 364-70. *See In re Health Mgmt. Sys., Inc. Sec. Litig.*, No. 97CIV.1865, 1998 WL 283286, at *6 (S.D.N.Y. June 1, 1998) (insider sales of significant amount of shares after announcement suggested no intent to defraud).

e. Ken Lay's Sales of Stock After the Price of Enron Began to Decline May Also Be Explained by a Need for Liquidity

Ken Lay's stock sales near the end of the class period, after the price of Enron stock had declined in value, may be explained by reasons having nothing to do with "insider information." As Hakala acknowledged, executives often have much of their net worth tied up in company stock. Hakala Decl. ¶¶ 12-13. It is therefore logical that when the price of the stock declines severely, they will experience liquidity problems. *See* Hakala Decl. ¶ 11. Plaintiffs, in another court filing, have highlighted publicity about liquidity problems Mr. Lay faced as a result of Enron's collapse, including his need to meet cash calls. *See* Second Supplemental Brief, *supra*. Plaintiffs also acknowledge that a need for liquidity is an acceptable reason for an officer to exercise options or sell stock. *See, e.g.*, Compl. ¶ 408 ("Premature sales of stock options are non-optimal, except for limited periodic sales for diversity or liquidity purposes.") Sales of stock necessitated by a change in financial situation caused by the declining price of an officer's stock do not raise a strong inference of scienter. *See, e.g.*, *Coates*, 26 F. Supp. 2d at 919-20 (forced sale of stock to satisfy margin call did not support an inference of a motive to inflate the price of the company's stock because the notion that an officer would engage in fraud and then wait for the stock price to plummet before selling his securities without benefitting from the fraud is a "non-sensical premise") (citing *Thornton*, 878 F. Supp. at 938); *MCI WorldCom*, 191 F. Supp. 2d at 792-93 (CEO's sale of stock to meet a margin call did not raise a strong inference of scienter). Plaintiffs have failed to plead any facts that would lead the Court to infer that Mr. Lay's inauspiciously timed sales after the price of Enron stock had fallen were driven by anything other than liquidity needs.[13]

---

[13] Plaintiffs suggest that Enron executives could have avoided a liquidity crisis from a (continued...)

f. Mr. Lay's Sales During the Class Period Are Also Explained by His Steps Toward Retirement

In December 2000, Enron announced that Jeffrey Skilling was named Enron's CEO to succeed Lay. Compl. ¶ 275. According to materials filed by plaintiffs with this Court, Mr. Lay, who was 58 years old, was contemplating retirement in 2001. Second Supplemental Brief, Ex. A; Enron 2001 Proxy Statement, p. 3. Thus, Mr. Lay's sales of Enron stock during the class period, particularly his 10b5-1 program sales from November 2000 to July 2001, may also be explained by the fact that he was taking steps toward retirement. Sales of stock in anticipation of retirement are not uncommon and do not support an inference of scienter. *See Greebel*, 194 F. 3d at 185, 206 (holding that sales of stock by retiring CFO were not suspicious because "[i]t is not unusual for individuals leaving a company . . . to sell shares").

When Mr. Skilling resigned in August 2001, Mr. Lay nevertheless returned to the position of CEO. *See* Compl. ¶ 343. If, in fact, Ken Lay knew (as plaintiffs contend) that Enron was on a path to disaster, he certainly would not have agreed to return as the leader of the company.

g. Plaintiffs' Attempt to Plead Scienter Based on the Collective Sales Made by Insiders is Improper Under the PSLRA

Finally, Plaintiffs cannot salvage their failure to plead scienter against Ken Lay through reliance on the collective sales purportedly made by all the defendants they have chosen to sue. *See* Compl. ¶¶ 401-04. Pursuant to the strict pleading standards governing Section 10(b) claims, plaintiffs must plead scienter with respect to each individual defendant. *See Schiller v. Physicians Res. Group,*

---

[13] (...continued)
fall in Enron stock price by executing a "costless collar", a simultaneous sale of call options and purchase of put options that would protect the stock's downside but also limit its upside. Compl. ¶ 409. Plaintiffs nowhere allege, however, that Mr. Lay ever executed such a costless collar. Indeed, to do so would have been inconsistent with a belief that the stock price would increase.

Inc., No. 3:97-CV-3158, 2002 WL 318441, at *10 n.10 (N.D. Tex. Feb. 26, 2002). Allegations regarding the defendants' collective state of mind are insufficient. *Id.* *See also Coates*, 26 F. Supp. 2d at 916-17 (plaintiffs must properly plead scienter as to each individual defendant).

h. In Summary, Plaintiffs' Allegations of Scienter Based on Mr. Lay's Stock Sales Do Not Raise Any Inference of Scienter, Much Less a Strong Inference

Plaintiffs' allegations of scienter against Ken Lay literally fall apart when the Court considers *what actually happened*. *See Thornton*, 878 F. Supp. at 937. Of Lay's sales during the class period, 31% were the result of his 10b5-1 selling program and the exercise of expiring options. Overall, his sales were inartfully timed to avoid an extended period when the stock traded at or near its high. Lay maintained a multi-million share Enron stock exposure throughout the class period. In the end, he left nearly one-half billion dollars in unrealized share value on the table. In June, July, and August 2001 he exercised options to buy *and hold* 218,620 shares of Enron stock, coming out of pocket over $4.6 million, plus taxes, to hold the stock. In August 2001 when the stock price had declined from its high of $90 by approximately one-half, Mr. Lay agreed to return to the position of CEO. His stock sales around that time (June 2001 through October 2001) were consistent with a need for liquidity after Enron stock had declined significantly in value.

An executive who artificially inflated Enron's share value through false statements and who supposedly knew that Enron was a "house of cards" would not hold on to so many Enron shares and options, sell at an average price approximately one-half of the trading high, and return to a leadership role in the company. "Plaintiffs' unpersuasive explanation appears to be, '[Ken Lay] committed fraud; [he] just [wasn't] very good at it.'" *See Thornton*, 878 F. Supp. at 938.

B. Plaintiffs' Remaining Scienter Allegations are Conclusory and Fail to Create a Strong Inference of Scienter

Plaintiffs' remaining allegations of scienter may be easily disposed of because they are insufficient and conclusory. The special standards Congress established in the PSLRA raised the pleading requirement to a "strong" inference of scienter. *Nathenson*, 267 F.3d at 411. "This standard may only be met on the basis of 'facts' which are 'state[d] with particularity' in the pleading." *Id.* Under the PSLRA, it is clear that conclusory allegations of scienter do not suffice to meet this standard. *Id.* at 419. Plaintiffs, however, offer a host of conclusory allegations in support of their scienter allegations.

1. Plaintiffs' Allegations That Mr. Lay Was Motivated to Commit Fraud in Order to Protect His Incentive-Based Compensation Are Insufficient

The plaintiffs contend generally that "every Enron Defendant" was motivated to commit fraud in order to protect the benefits of their incentive-based compensation. Compl. ¶ 396. In this regard, the plaintiffs claim that the Enron defendants were "in a position" to receive cash bonuses and realize profits on their Enron stock if Enron reached its earning targets and its stock advanced. Allegations of scienter based on preserving incentive-based compensation, however, are inadequate to plead scienter because "[a]ccepting the plaintiff's allegation of motive -- basically that the defendant officers and directors were motivated by incentive compensation -- would effectively eliminate the state of mind requirement as to all corporate officers and directors." *Melder v. Morris*, 27 F.3d 1097, 1102 (5th Cir. 1994) (citing *Tuchman*, 14 F.3d at 1068-69).

Incentive based compensation is commonplace in today's business environment. *See In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1424 (3d Cir. 1997) ("A large number of today's corporate executives are compensated in terms of stock and stock options."); *see also Wilson v.*

Bernstock, No. 01-0272, -- F. Supp. 2d --, 2002 WL 334688, at *12 (D.N.J. Jan. 29, 2002) ("Incentive compensation in the form of stock options and performance-based bonuses is very common.").

> Indeed, one of the purposes for this type of compensation arrangement is to link executives' own personal financial success to that of the company they are charged with operating so as to create an added incentive for top business managers to prudently manage the company's business and maximize the value of shareholders' investment. For this reason, courts have uniformly held that incentive compensation alone cannot provide a sufficient basis on which to support allegations of a motive to create the illusion of corporate profitability, whether by active misrepresentation or wrongful nondisclosure of materially adverse information.

Id. (holding that incentive compensation of CEO in the form of bonus awards was insufficient to raise a strong inference of scienter).

In *In re Azurix Corp. Sec. Litig.*, No. H-00-4034, 2002 WL 562819 (S.D. Tex. March 21, 2002), the court dismissed allegations that Mr. Lay, among other executives, was motivated to commit fraud in order to increase his compensation under a compensation system very similar to Enron's:

> Azurix's executive compensation program was designed to reward performance that directly correlated with Azurix's success. . . . These awards are tied to performance in that the executive only realizes income from stock options if the stock price rises. Plaintiffs claim that . . . Lay . . . owned shares of Azurix common stock and [was] subject to these compensation provisions. The alleged desire to increase compensation does not support a strong inference of scienter . . . because, if accepted, such allegations would essentially eliminate the state of mind requirement as to all corporate officers and directors.

Id. at *22 (quotations omitted). Numerous courts have held similarly. *See, e.g., BMC Software*, 183 F. Supp. 2d at 896 (motives possessed by nearly all corporate insiders such as to ensure a high stock price to increase executives' compensation are insufficient to plead scienter); *Branca v. Paymentech, Inc.*, No. 3:97-CV-2507, 2000 WL 145083, at *10 (N.D. Tex. Feb 8, 2000) (allegation that CEO was motivated to falsely inflate price of company stock because she took a significant portion of her compensation in stock options was insufficient to raise an inference that she acted with fraudulent intent); *Party City*, 147 F. Supp. 2d at 314 (explaining that incentive compensation can hardly be a basis on which an allegation of fraud is predicated); *MCI WorldCom, Inc.*, 191 F. Supp. 2d at 793 (allegation that CEO desired to increase his incentive compensation, which was tied in part to the price of the company's stock, did not contribute to a strong inference of scienter). Plaintiffs' claims that Mr. Lay was motivated to commit fraud in order to enhance his incentive-based compensation must therefore fail.

2. Plaintiffs' Allegation That the "Enron Defendants" Were Motivated to Commit Fraud to Keep the Stock Price High for the Ongoing Success of the Business Are Insufficient

Continuing their conclusory allegations of scienter, the plaintiffs allege that the "Enron Defendants" were motivated to commit fraud because the ongoing success of the business depended on keeping Enron stock price trading at high levels. Compl. ¶ 396. As this Court has explained, however, "motives possessed by nearly all corporate insiders, e.g., a wish to uphold a high credit rating [or to sustain the image of profitability or successful investment] are not sufficient to plead scienter." *BMC Software*, 183 F. Supp. 2d at 896; *see also Schiller*, 2002 WL 318441, at *8 (allegation that defendants were motivated to inflate company stock price in order to be perceived as a growth company and because its entire business would fail if it could not maximize its stock price held insufficient to plead scienter under *Nathenson*); *Azurix*, 2002 WL 562819, at *22-23 (allegations that defendants attempted to inflate the company stock price to facilitate the raising of capital so that the company could use its stock as currency for numerous acquisitions held insufficient to plead scienter against Mr. Lay).

3. Plaintiffs' Conclusory Allegations that the Defendants "Knew" the Purported Truth About Enron Because of their Positions and Access to Information Are Insufficient

Finally, plaintiffs attempt to plead scienter by alleging in conclusory fashion that the Enron defendants "knew" the purported truth about Enron's financial and operational difficulties. For example, plaintiffs allege that "it is logical, if not obvious, that all of Enron's officers and directors knew of, or at a minimum acted in reckless disregard of, the falsification of Enron's financial reports and the other false and misleading statements being made about its business operations." Compl. ¶ 395. Courts have routinely held, however, that such conclusory allegations do not satisfy Rule 9(b), much less the PSLRA. *See Nathenson*, 267 F.3d at 419-20 ("Under the PSLRA it is clear that conclusory allegations of state of mind do not suffice for this purpose, as we have indeed held in cases governed by pre-PSLRA law."); *see also Calliott v. HFS, Inc.*, No. 3:97-CV0924, 2000 WL 351753, at *8 (N.D. Tex. Mar. 31, 2000) ("Throughout the Complaint, Plaintiffs state in conclusory fashion that Defendants 'knew,' 'should have known,' 'were reckless' in not knowing, and 'falsely' stated particular facts. This type of conclusory recitation 'fails to provide the specific facts upon which an inference of conscious behavior may be based.'") (citing *Melder*, 27 F.3d at 1032); *Thornton*, 878 F. Supp. at 936 ("Again, plaintiffs have not provided any *facts* to support their *conclusion* that the defendants 'knew' or 'recklessly ignored' these problems. . . .").

Similarly, plaintiffs claim in conclusory fashion that, by virtue of Enron defendants' positions within the company and their participation on various committees, they controlled the contents of Enron's regulatory filings and other public statements. *See* Compl. ¶ 397. Plaintiffs also allege that the "Enron Defendants" knew these documents were false and misleading and participated or acquiesced in the issuance of these statements. *Id.*, ¶ 400. Plaintiffs claim that the defendants knew that Enron's public documents and other statements were false and misleading because they received "information" reflecting the true facts regarding Enron and had access to "internal corporate documents." *Id.*, ¶¶ 399-400. The plaintiffs also contend that the defendants knew the allegedly true state of Enron's affairs through "conversations and connections with other corporate officers and employees." *Id.*, ¶¶ 397-400.

In *In re Azurix Corp. Sec. Litig.*, No. H-00-4034, 2002 WL 562819 (S.D. Tex. Mar. 21, 2002), a court in this district recently held that a virtually identical form of pleading was insufficient to plead scienter against Mr. Lay and other executives in connection with alleged misrepresentations and omissions regarding Azurix, a global water company formed by Enron:

> Plaintiffs allege that the individual defendants had the opportunity to commit and participate in wrongful conduct because each was a senior executive officer, director, or controlling shareholder of Azurix and thus controlled the information disseminated to the investing public in press releases, SEC filings, and communications with analysts. Plaintiffs conclude, without any factual basis for these claims, that each defendant therefore must have falsified the information that reached the public concerning Azurix's business and financial condition. Merely alleging that the defendants knew or had access to information by virtue of their board or managerial positions is not sufficient to plead scienter. Because plaintiffs have put forth only conclusory allegations in support of their claims, their claims fail.

Id. at *23 (dismissing securities fraud claims against Mr. Lay) (citations omitted).

Moreover, conclusory allegations that the Enron defendants had access to adverse material non-public information by virtue of their positions within the company are insufficient to plead scienter:

> A director, officer, or even the president of a corporation often has superior knowledge and information, but neither the knowledge nor the information invariably attaches to those positions, . . . and plaintiffs have not pointed to specific reports, circulated among defendants, which contained the adverse information defendants are charged with knowing.

In re Advanta, Corp., Sec. Litig., No. 97-CV-4343, 1998 WL 387595, at *7 (E.D. Pa. July 9, 1998) (citations omitted), *aff'd*, 180 F.3d 525 (3d Cir. 1999); *see also Zishka v. American Pad & Paper Co.*, No. 398CV0660, 2001 WL 1645500, at *4 (N.D. Tex. Dec. 20, 2001) (dismissing securities fraud claim against CEO and declining to engage in a presumption that high level officers have knowledge of facts or events critical to the company's business). Similarly, generalized claims that the defendants had access to internal documents and information and therefore must have known the "truth" also fail. *See, e.g., Branca*, 2000 WL 145083, at *10-11 (allegations that the defendant knew or should have known that false representations were being made merely by virtue of his position within a company and his purported "unfettered access" to internal financial information are insufficient to plead scienter); *Splash Tech.*, 2000 WL 1727377, at *21 (allegation that defendants had access to unspecified internal corporate documents; had "conversations" with unspecified corporate officers and employees; and attended unspecified management and/or board meetings were insufficient to plead scienter).

Based on the above discussion, Plaintiffs' § 10(b) and 10b-5 claims against Mr. Lay must be dismissed because Plaintiffs have failed to plead *facts* with particularity giving rise to a *strong* inference of scienter. *See Nathenson*, 267 F.3d at 410-11.

III. Similarly, Plaintiffs Have Not Pleaded a § 20A Claim Against Mr. Lay

Section 20A of the Securities Exchange Act of 1934 provides for recovery by contemporaneous purchasers of securities sold in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 when the seller was "in possession of material, nonpublic information."[14] As this Court recognized in *In re BMC Software, Inc. Sec. Litig.*, 183 F. Supp. 2d 860, 916 (S.D. Tex. 2001):

> To state a claim for securities fraud based on insider trading in a private cause of action under § 10(b) and Rule 10b-5 and § 20A of the Exchange Act, a plaintiff must show that a defendant (1) used material nonpublic information, (2) knew or recklessly disregarded that the information was material and nonpublic, and (3) traded contemporaneously with the defendant.

To allege a claim under § 20A, plaintiffs must first allege a violation of § 10(b) and Rule 10b-5. *See Lipton v. Pathogenesis Corp.*, 284 F.3d 1027, 1035 n. 15 (9th Cir. 2002); *In re VeriFone Sec. Litig.*, 11 F.3d 865, 872 (9th Cir. 1993). Since scienter is an essential element of a § 10(b) and Rule 10b-5 claim, they must also plead specific facts raising a strong inference of scienter to support their § 20A claim. *See id.*; 53 S.E.C. Docket Release No. 7881, 2000 WL 1201556, * 21 (Aug. 15, 2000) ("Scienter remains a necessary element for liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Rule 10b5-1 does not change this.")

Under the PSLRA and Rule 9(b), plaintiffs must allege specifically what nonpublic information each defendant used to trade and how they knew such information was material or nonpublic. *See BMC Software*, 183 F. Supp. 2d at 916. Generalized allegations of insider trading do not suffice. A general contention that a defendant knew that information was material or nonpublic by virtue of

---

[14] Section 20A specifically provides:

> Any person who violates any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable in an action in any court of competent jurisdiction to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class.

15 U.S.C. § 78t-1(a).

his position and day-to-day business activity fails to meet the heightened pleading requirements of the PSLRA. *See id.*

Plaintiffs utterly fail to make any specific allegation detailing material, nonpublic information that was supposedly used by Mr. Lay to sell Enron shares at any particular time. *See* Compl. ¶¶ 998-1004. Nor do they allege, or can they allege, how he knew that any such information was material or nonpublic. *Id.* Instead, plaintiffs rely on generalized allegations that the defendants had access to information about the company by virtue of their positions. Compl. ¶ 1001. These allegations are clearly unacceptable, as this Court found in *BMC Software,* 183 F. Supp. 2d at 916.

Plaintiffs also generally allege that all the defendants had possession of material, non-public information "about the adverse information detailed herein." Compl. ¶ 1002. They thus invite the defendants to review 500 pages of pleading and guess what "adverse information" each one supposedly knew before each sale of Enron stock. This pleading is the antithesis of particularity.

Plaintiffs also fail to allege specific facts raising a strong inference of scienter in connection with their § 20A claim against Ken Lay. They do not even attempt to make any separate showing of scienter to support this claim. Presumably, plaintiffs rely on the general scienter section of their consolidated complaint, and therefore pin their hopes on the purported analysis of Lay's Enron stock option exercises and stock sales done by Scott Hakala. Compl. ¶¶ 395-416. Even if this Court were to construe the general scienter section to apply to plaintiffs' § 20A claim, it fails to satisfy the heightened pleading burden of the PSLRA for the reasons discussed above in section II of this brief.

Plaintiffs do not even begin to satisfy the "who, what, when, where, how" pleading requirements for alleging that particular sales by Ken Lay violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, entitling them to recovery under § 20A. Plaintiffs also fail to meet the

PSLRA's scienter pleading requirement. Their skeletal pleading of § 20A violations must therefore be dismissed.

IV. The Plaintiffs' Federal Securities Claims Must Be Dismissed Because Plaintiffs Have Not Pleaded the Remaining Elements of Their § 10(b) Claims Pursuant to FED. R. CIV. P. 9(b) and the PSLRA

The plaintiffs' § 10(b) pleading deficiencies do not end with their scienter and insider trading allegations. Plaintiffs' complaint must be dismissed for the additional reason that it fails to advise Ken Lay of the specific fraudulent conduct with which he is charged.

A. The FED. R. CIV. P. 9(b) and PSLRA Pleading Standards

Rule 9(b) is intended to identify and discard complaints that fail to provide a defendant with fair notice of the claims against him. *Melder v. Morris*, 27 F.3d 1097, 1100 (5th Cir. 1994) (quoting *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994)). Rule 9(b) requires a plaintiff "to specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent." *Nathenson*, 267 F.3d 408, 412 (5th Cir. 2001) (quoting *Williams v. WMX Technologies, Inc.*, 112 F.3d 175, 177 (5th Cir. 1997)). To satisfy this requirement, a plaintiff must plead facts, not merely conclusory allegations. *Tuchman*, 14 F.3d at 1067-68; *BMC Software*, 183 F. Supp. 2d at 895. The Fifth Circuit advocates a strict interpretation of Rule 9(b), stating that it must be applied "with force, [and] without apology." *Williams*, 112 F.3d at 178.

The pleading standard for securities fraud claims such as this is higher still. In 1995, Congress passed the PSLRA to enhance Rule 9(b)'s mandate that plaintiffs plead their fraud claims with particularity. Under the PSLRA, a complaint must specify each statement alleged to have been misleading, and the reason or reasons why the statement is misleading. *See* 15 U.S.C. § 78u-4(b)(1) and (2).

B. The Plaintiffs Have Failed to Advise Each Individual Defendant of the Specific Fraudulent Conduct with Which He or She is Charged

The plaintiffs fail to identify specifically the speaker purportedly responsible for each alleged misrepresentation in their complaint. Often, in pleading an alleged misrepresentation, omission, or other element of their claim, the plaintiffs refer to multiple individual defendants collectively as the "defendants" or "Enron Defendants."[15] The plaintiffs also attribute several statements to more than one defendant without identifying specifically which defendant made the statement, when it was made, and to whom it was made.[16]

When multiple defendants are named in a lawsuit, the complaint should inform each defendant of the nature of his alleged participation in the fraud. *Thornton*, 878 F. Supp. at 938.

> A plaintiff must "plead with sufficient particularity attribution of the alleged misrepresentations or omissions to each defendant; the plaintiff is obligated to 'distinguish among those they sue and enlighten each defendant as to his or her part in the alleged fraud.'"

Coates v. Heartland Wireless Communications, Inc., 26 F. Supp. 2d 910, 915 (N.D. Tex. 2000) (quoting *In re Silicon Graphics Inc. Sec. Litig.*, 970 F. Supp. 746, 752 (N.D. Cal. 1997)). The plaintiffs' failure to distinguish between the defendants they sue and advise each one of his or her alleged participation in the fraud violates FED. R. CIV. P. 9(b) and requires dismissal of plaintiffs'

---

15 *See, e.g.*, Compl. ¶¶ 396, 418, 433, 536, 587, 594, 601.

16 *See, e.g.*, Compl. ¶ 224 attributing eleven alleged misrepresentations to Lay, Skilling, Koenig, Causey, and Fastow, and stating that "they" purportedly made the various statements "during the conference call -- and in follow-up conversations with analysts and in a formal presentation and break-out sessions at the analyst conference."

complaint. *See Coates*, 26 F. Supp. 2d at 916 ("plaintiffs must properly plead wrongdoing and scienter as to each individual defendant"); *see also Branca*, 2000 WL 145083, at *8 (conclusory allegations against the "Individual Defendants" fail to satisfy Rule 9(b)).

C. The Group Pleading Doctrine Did Not Survive Passage of the PSLRA

The plaintiffs also treat the "Enron Defendants" as a group for pleading purposes and ask the Court to presume that the allegedly misleading information conveyed in the company's public filings, press releases, and other publications are the collective actions of the "Enron Defendants." Compl. ¶¶ 89-90. This Court and several others, however, have held that the group pleading doctrine did not survive enactment of the PSLRA. *See, e.g., BMC Software*, 183 F. Supp. 2d 903 n.45 ("[T]his Court believes more stringent pleading is required by the [PSLRA], [and] it agrees with those district courts that find the group pleading doctrine is at odds with the [PSLRA] and has not survived the amendments."); *Coates*, 26 F. Supp. 2d at 916 (group pleading is inconsistent with the provisions of the PSLRA and contrary to its underlying policies); *Branca*, 2000 WL 145083, at *8 (the PSLRA bars use of group pleading techniques); *Schiller*, 2002 WL 318441, at *5 (the group pleading doctrine did not survive enactment of the PSLRA); *Zishka v. American Pad & Paper Co.*, No. 3:98-CV-0660, 2000 WL 1310529, at *1 (N.D. Tex. Sept. 13, 2000) (same).

As a result, the plaintiffs' complaint, which employs this inappropriate pleading technique throughout, must be dismissed.

V. Plaintiffs' Alleged Misrepresentations Are Not Pleaded Adequately and Are Not Actionable

Moreover, those alleged misrepresentations that plaintiffs do attribute to Mr. Lay are flawed in several respects. First, plaintiffs attempt, impermissibly, to rely on alleged misrepresentations made before the class period. Second, plaintiffs have failed to plead their alleged misrepresentations in accordance with the strict standards imposed by the PSLRA and Rule 9(b). Finally, the alleged misrepresentations are not actionable because they were general expressions of optimism or forward-looking statements protected by the PSLRA and the bespeaks caution doctrine.

A. Plaintiffs' Alleged Misrepresentations Made Before the Class Period Are Not Actionable

Plaintiffs' complaint impermissibly attempts to rely upon several alleged misrepresentations occurring before October 19, 1998, the first day of the class period. Compl. ¶¶ 109-21. As a matter of law, the alleged pre-class period statements cannot constitute actionable securities fraud.

The Second Circuit addressed this precise issue in *In re International Bus. Mach. Corp. Sec. Litig.*, 163 F.3d 102 (2d Cir. 1998). There, the plaintiffs attempted to rely on an alleged misrepresentation by an IBM official made one day before the class period began. *Id.* at 107. The court held that "[a] defendant . . . is liable only for those statements made during the class period." *Id.* *See also In re Clearly Canadian Sec. Litig.*, 875 F. Supp. 1410, 1420 (N.D. Cal. 1995) (striking alleged statements made before and after class period). The Court therefore should dismiss plaintiffs' alleged misrepresentations occurring before October 19, 1998. *Cf. In re Waste Mgmt., Inc. Sec. Litig.*, No. 4-99-2222, slip op. at 188 (S.D. Tex. Aug. 16, 2001) ("reliance on Waste Management's history of manipulation, accounting fraud, and securities law violations, including the recent $7 million penalty imposed on Arthur Andersen L.L.P. for not reporting Waste Management's misrepresentations or its earnings *in years preceding the class period*, is also improper") (emphasis added).

B. Plaintiffs Have Failed to Identify When and Where Certain Alleged Misrepresentations Relating to Lay Were Made, or the Source for Such Alleged Misrepresentations

First, plaintiffs allege that Skilling, "[f]aced with this impending catastrophe on 7/13/01, . . . told Lay that he was going to quit because he knew that the Enron house of cards was crumbling." Compl. ¶ 57. Plaintiffs then allege that Lay, Skilling and others falsely presented Skilling's resignation as having been for personal reasons. *Id.* In contravention of Rule 9(b) and the PSLRA, plaintiffs have failed to identify the location where Skilling made this alleged statement to Ken Lay. *Williams v. WMX Tech., Inc.*, 112 F.3d 175, 177 (5th Cir. 1997) (Rule 9(b) particularity requirements include, among other things, the place of the alleged misrepresentation); 15 U.S.C. § 78u-4(b)(1). Further, because the alleged conversation between Lay and Skilling plainly is not within plaintiffs' personal knowledge, plaintiffs' allegation is deemed to be on information and belief and they are required to identify the source for Skilling's alleged statement and how plaintiffs learned of the alleged statement. *See Splash Tech.*, 2000 WL 1727377, at *12 (complaint failing to demonstrate personal knowledge is deemed on information and belief, and plaintiffs' complaint must allege source of plaintiffs' information and how plaintiffs learned of information). Because plaintiffs have failed to allege the place of Skilling's alleged statement or the source for this allegation, plaintiffs' allegation that Skilling told Ken Lay Enron "was a house of cards" should be dismissed.

Second, plaintiffs' allegation in paragraph 275 also fails to satisfy the requirements of Rule 9(b) and the PSLRA. Plaintiffs allege that Skilling was named as Enron's CEO to succeed Lay on December 13, 2000. Compl. ¶ 275. Plaintiffs purport to quote Lay as saying:

> "The best time for the succession to occur is when the company is doing well," said Lay, who said revenue could top $90 billion this year, up from about $40 billion in 1999. "Enron is doing extremely well now."

Id.

Plaintiffs do not identify where Mr. Lay's alleged statement was made or the source for the alleged statement. *Id.* Further, although plaintiffs allege that Skilling was named CEO on December 13, 2000, they fail to allege the date of Lay's alleged statement. Paragraph 275 therefore should be dismissed. *See Williams*, 112 F.3d at 180 (dismissing complaint due to lack of particularity).

In addition, one of the analyst reports relied upon by plaintiffs mentions Lay by name, but fails to satisfy the pleading requirements of Rule 9(b) and the PSLRA. Compl. ¶ 353. Plaintiffs allege that an August 17, 2001, Lehman Brothers report states: "Last night, we met with Ken Lay and other members of senior management. The Enron machine is in top shape and continues to roll along. We don't see any reason to change our estimates or outlook." *Id.* Plaintiffs have failed to allege where this meeting took place or any particular statement that Ken Lay made at the meeting. *Id.* Moreover, plaintiffs have also failed to allege with particularity that Lay had involvement in or control over the content of the Lehman Brothers analyst report, as well as any other analyst report cited in plaintiffs' complaint. *See BMC Software*, 183 F. Supp. 2d at 872 n.21 ("This Court agrees with the majority view that there must be alleged facts showing some involvement and control over the content of the analysts' reports by the defendants to hold them liable for misleading statements made in those reports.").

C. Plaintiffs Have Not Alleged with Particularity that Lay's Alleged Misrepresentations Were False When Made

Plaintiffs allege that Ken Lay has made twenty-eight (28) different misrepresentations, excluding plaintiffs' impermissible group pleading allegations. Despite their massive 501-page complaint, plaintiffs never allege specifically why any single statement they attribute to Lay was false when made. Instead, plaintiffs have divided their complaint into various sections in which they first list numerous statements by Lay and the other defendants, and then provide a lengthy section of supposed "true but concealed facts," with no explanation of the connection between the alleged statements and the alleged concealed facts. The end result is a complaint that is not only indecipherable, but is also in blatant violation of the pleading requirements of Rule 8, Rule 9(b), and the PSLRA.

Under Rule 9(b) and the PSLRA, plaintiffs are required to plead with particularity facts showing that an alleged misrepresentation was false when made. *See, e.g., Nathenson*, 267 F.3d at 412; 15 U.S.C. § 78u-4(b)(1) and (2). The particularity requirement, however, is not an invitation to submit an incomprehensibly voluminous complaint. Thus, plaintiffs must allege their particularized facts in a "simple, concise, and direct" pleading containing "a short and plain statement" of their various alleged claims for relief. *See* FED. R. CIV. P. 8(a), 8(e)(1). Numerous courts have dismissed securities complaints employing a virtually identical pleading style as that employed by plaintiffs here, holding either that the complaint failed to comply with Rule 9(b) and the PSLRA, or that the complaint failed to comply with Rule 8, or both. *See In re Splash Tech. Holdings, Inc.*, 160 F. Supp. 2d 1059, 1073-75 (N.D. Cal. 2001); *Copperstone v. TCSI Corp.*, No. 97-3495, 1999 WL 33295869, at *16 (N.D. Cal. Jan. 19, 1999); *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1243-44 (N.D. Cal. 1998); *In re Dura Pharm., Inc. Sec. Litig.*, No. 99CV0151, 2000 WL 33176043, at *6-11 (S.D. Cal. July 11, 2000); *In re Oak Tech. Sec. Litig.*, No. 96-20552, 1997 WL 448168, at *9-12 (N.D. Cal. Aug. 1, 1997). The court in *Wenger* explained the problem as follows:

> Determining whether 'the pleader is entitled to relief' requires a laborious deconstruction and reconstruction of a great web of scattered, vague, redundant, and often irrelevant allegations. The Complaint repeats many allegations three or four

> times, often giving them a slightly different flourish at each turn. In violation of the Reform Act's requirement that a complaint must specify the reasons why *each* statement is alleged to have been misleading, the Complaint lumps all alleged misrepresentations together in one unwieldy 14-page segment (the statements span eight months, from November 1995 to June 1996) and then follows that catalog with a three-page laundry list of reasons why *all* the statements were allegedly false when made. . . . Plaintiff merely throws the statements and the alleged 'true facts' together in an undifferentiated clump and apparently expects the reader to sort out and pair each statement with a supposedly relevant 'true fact.' The predictable demands of reviewing such a complaint abuse judicial resources.

Wenger, 2 F. Supp. 2d at 1243 (internal citations omitted).

In this case, plaintiffs' complaint is an exercise in obfuscation that, if allowed, would force Lay to grasp at the wind as he attempts to tackle plaintiffs' alleged misrepresentations. For example, plaintiffs allege Ken Lay stated that "Bandwidth trading could provide us with our highest potential growth," and further stated that Enron hoped to capture 10-20% of a market Enron expected to grow to $95 billion per year by 2004. Compl. ¶ 212. Upon inspecting the supposed "true but concealed facts," the Court will discover that plaintiffs never even refer to the growth potential for fiber optic trading, the market for bandwidth trading, or Enron's ability to capture market share, much less explain how Mr. Lay's statements were allegedly false. Compl. ¶ 214. Lay is instead left to decipher nearly two pages of general allegations relating to Enron's broadband division.

Similarly inexplicable is plaintiffs' allegation that Ken Lay committed fraud when, as part of a press release announcing $1 billion in additional financing, he allegedly stated: "With more than $1 billion in cash currently on our balance sheet, this additional credit capacity will further solidify Enron's standing as the leading market maker in wholesale energy markets." Compl. ¶ 383. Plaintiffs allege that each statement between October 16, 2001, and November 14, 2001 was false and misleading, but they never challenge the amount of cash on Enron's balance sheet or Enron's standing as the leading market maker in wholesale energy markets. Compl. ¶ 390. These statements merely represent examples drawn from a complaint that is wholly deficient because it fails to allege with particularity that any of Ken Lay's alleged misrepresentations were false when made. Based on the structural deficiency of plaintiffs' complaint, the Court should dismiss plaintiffs' complaint in its entirety.

But even if the Court were to attempt to decipher plaintiffs' fatally flawed complaint -- which it should not -- plaintiffs have still failed to allege with particularity why Lay's alleged misrepresentations were false when made. "[W]ithout specific references to specific facts demonstrating that the statements at issue were false or misleading when made, allegations regarding adverse information supposedly known to defendants are merely speculation and conclusions drawn from hindsight." *Wenger*, 2 F. Supp. 2d at 1250 (internal quotation and citation omitted). To meet this burden, plaintiffs must "point to contemporaneous, inconsistent statements by defendants or show that information available to defendants showed different results than defendants predicted." *Wenger*, 2 F. Supp. 2d at 1240; *see also San Leandro Emer. Med. Group Profit Sharing Plan v. Philip Morris Co.*, 75 F.3d 801, 812-13 (2d Cir. 1996) (noting that plaintiffs had not pointed to specific reports, circulated among defendants, showing that alleged misrepresentations were false when made).

Mr. Lay's alleged statement on October 16, 2001, illustrates plaintiffs' failure to allege with particularity facts showing that Lay's statements were false when made. When Lay was asked whether Enron would be taking additional large charge-offs in the future, Lay allegedly responded "If we thought there were any other significant concerns, we would have taken care of them today."[17]

---

[17] As discussed in section V(E)(4), plaintiffs' quotation ignores the cautionary statements Mr. Lay made the same day.

Compl. ¶ 367. Plaintiffs allegation of falsity relies on pure hindsight, contending that "the write-offs taken by Enron on 10/16/01 did not clean up its balance sheet . . . [because] there were billions of dollars of additional overvalued assets still on Enron's balance sheet."[18] *Id.*, ¶ 390. Noticeably absent from plaintiffs' complaint are any allegations of specific documents or other information available to Lay that would render Lay's statement false when made.[19]

D. Most of the Alleged Misrepresentations by Lay Constitute Nothing More Than Inactionable Puffing

"[I]t is well-established that generalized positive statements about a company's progress are not a basis for liability." *Nathenson*, 267 F.3d at 419. As this Court explained in *BMC Software*, "[v]ague, loose optimistic allegations that amount to little more than corporate cheerleading are 'puffery,' projections of future performance not worded as guarantees." *BMC Software*, 183 F. Supp. 2d at 888. The Court further explained that puffery is "not actionable under federal securities law because no reasonable investor would consider such vague statements material and because

---

[18] Ken Lay contends that plaintiffs' complaint is deficient in its entirety because of the failure to allege particular facts raising a strong inference of scienter. *See supra,* section II. Although there is often a fine line between the failure to allege that the defendant knew the allegation was false and the failure to allege that the allegation was false when made, this is an example of an alleged misrepresentation that is deficient for both reasons.

[19] At several places in their complaint, plaintiffs refer to memoranda written by Enron's Sherron Watkins to the Board of Directors or to Lay. *See* Compl. ¶¶ 59, 340, 800. Plaintiffs make no attempt to connect Watkins' memoranda to any alleged misrepresentation by Lay. Even according to plaintiffs' allegations, Lay first received a memorandum from Watkins in August 2001. Indisputably, Lay met with Watkins to hear her concerns and promptly requested that Enron's General Counsel, James Derrick, investigate the issues raised in the letter. Derrick then retained the law firm of Vinson & Elkins to conduct the investigation. *Id.*, ¶ 800. Vinson & Elkins concluded no further investigation was necessary. Plaintiffs nonetheless complain about the nature and scope of the investigation into the issues raised by Watkins. At most, plaintiffs have raised issues about the management decisions relating to the details of the investigation -- issues that are not actionable under the securities laws. *See Tuchman*, 14 F.3d at 1070 (mismanagement not actionable).

investors and analysts are too sophisticated to rely on vague expressions of optimism rather than specific facts." *Id.*

Applied here, the alleged misrepresentations by Ken Lay in the following paragraphs of plaintiffs' complaint constitute nothing more than inactionable puffery: Paragraphs 112, 114, 115, 145, 156, 168, 177, 196, 212, 240, 241, 246, 275, 281, 293 (first excerpt), 343, 353, 356, 366, 368, 369, 377, 382, 388.[20] For example, plaintiffs' alleged misrepresentations include the following:

- "We have experienced a strong market reception [for Wholesale Energy Operations and Services] and very successful contracting results, and we are very pleased about the prospects for this dynamic business." Compl. ¶ 128.

- "[W]e are positioned to be the leading player in the largest and fastest growing markets in the world. The outlook for the company is excellent." Compl. ¶ 156.

- "Bandwidth trading could provide us with out highest potential growth," said Lay. Enron expects the market for trading space on fiber optic networks to more than triple to $95 billion per year by 2004. The company hopes to capture 10-20% of that revenue, Lay told analysts. Compl. ¶ 212.

- "Entertainment on-demand is perhaps the most visible example of the power of Enron's broadband applications. With Blockbuster's extensive customer base and content, and Enron's network delivery application and the capabilities of the distribution providers, we have put together the 'killer app' for the entertainment industry," said Lay. Compl. ¶ 240.

- "[I]t means that we're going to change the whole entertainment experience for the average American over the next few years . . . . [T]he main thing about the agreement is it's a 20-year exclusive agreement between Blockbuster and Enron, to provide

[20] Several of these paragraphs also suffer from additional fatal deficiencies. Paragraphs 112, 114, and 115 contain alleged misrepresentations occurring before the class period, which are not actionable. *See supra,* section V(A). Further, paragraphs 145, 366, 377, and 388 constitute impermissible group pleading allegations because plaintiffs have failed to identify the speaker. *See supra*, section IV(B) and (C). Moreover, plaintiffs have failed to allege with particularity that the statements were false when made in all of these paragraphs (*supra*, section V(C)); have included immaterial recitations of historical facts (*infra*, section V(F)); and include forward-looking statements protected under the PSLRA (*infra*, section V(E)).

> entertainment on demand . . . . [W]e bring in our technology and our broadband system, worldwide." Compl. ¶ 241.

The above statements by Lay epitomize the type of vague and optimistic comments that courts have repeatedly deemed puffery. Indeed, courts have found strikingly similar statements to be too vague and generalized to support a securities claim. *See Nathenson*, 267 F.3d at 419 (describing new drug as "fast acting" and "improved formulation" was "nothing more than inactionable puffing"); *Raab v. General Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993) (saying company "is poised to carry the growth and success of 1991 well into the future" not actionable); *In re Browning-Ferris Indus. Inc. Sec. Litig.*, 876 F. Supp. 870, 885-86, 897 (S.D. Tex. 1995) (statements that "the future prospects of our solid waste collection and disposal business are extremely attractive" and that company's "growth prospects are just as attractive today as they have been in the last few years" were puffery); *Kurtzman v. Compaq Computer Corp.*, No. H-99-779, slip op. at 50-51, 57 (S.D. Tex. Mar. 30, 2002) (statements that "the organizations are completely integrated and merged" and that "[t]he synergies from the Digital acquisition are becoming more and more evident in our financial performance" were puffery); *Azurix*, 2002 WL 562819, at *18-19 (statements that the second quarter of 1999 was "a period of significant accomplishment for Azurix," that Azurix's "pipeline of private transactions and announced public tenders remains very strong," and that Azurix's "fundamentals are strong" all too vague and general to support claim); *Greebel*, 194 F.3d at 190, 207 (statements that software product would "lead the market" and that networking business was "cash cow" that would fund development of other businesses "are not actionable"). At most, Lay's statements constitute corporate cheerleading upon which no reasonable investor would rely. *See BMC Software*, 183 F. Supp. 2d at 888.

Plaintiffs' alleged misrepresentations also include Ken Lay's future financial projections for Enron. For example, plaintiffs challenge Lay's statements on October 16, 2001, that Enron had "reconfirmed in our earnings release this morning that we expect to hit the fourth quarter numbers that we have been projecting and $1.80 for this year and $2.15 for next year[,]. . . .[s]o , again, about another 20 percent growth in earnings per share for next year." Compl. ¶ 369; *see also id.*, ¶ 368. Projections of future performance will be actionable only when supported by specific statements of fact or worded as guarantees. *Malone v. Microdyne Corp.*, 26 F.3d 471, 479-80 (4th Cir. 1994); *see also Krim v. BancTexas Group, Inc.*, 989 F.2d 1435, 1446 (5th Cir. 1993) ("projections of future performance not worded as guarantees are generally not actionable"). Far from guaranteeing Enron's future performance, Lay couched his October 16, 2001, statements in terms of expectations and projections. *See Herman v. Legent Corp.*, 50 F.3d 6 (table), No. 94-1445, 1995 WL 115879, at *4-5 (4th Cir. Mar. 20, 1995) (CEO's statement that company was "firmly on its 1993 plan for revenue and earnings growth" lacked necessary specificity and was not actionable, despite internal memo warning revenue for certain business lines" was far short of budget). For this reason alone, all claims based on Lay's October 16, 2001, statements, as well as his other financial projections, should be dismissed.

Further, Mr. Lay's statements in the fall of 2001 -- which indisputably were made during very trying times for Enron -- plainly were not material to the market because Enron's stock continued to plummet despite Lay's comments.[21] *See Azurix*, 2002 WL 562819, at *19 ("Because

---

[21] By alleging that Lay's statements in the summer and fall of 2001 failed to sway the market, plaintiffs effectively have conceded that Lay's alleged statements were not material. *See* Compl. ¶ 342 ("Despite efforts . . . to support Enron's stock during 5/01-7/01, it continued to erode"), ¶ 360 ("While Enron . . . made a valiant effort during the last half of 8/01 and 9/01 to assure (continued...)

plaintiffs fail to allege that defendants' favorable and allegedly false and/or misleading statements had a correspondingly favorable impact on Azurix's share price, and because plaintiffs' complaint demonstrates that these statements did not have a favorable effect on Azurix's share prices, the court concludes that these statements, even if misleading, were not material and that plaintiffs did not rely on them.").

Similarly defective are plaintiffs' allegations that Mr. Lay made misrepresentations in connection with Jeffrey Skilling's resignation. Plaintiffs allege that Lay was asked a question about the reason for Skilling's departure and responded that "there is absolutely no problems that had anything to do with Jeff's departure . . . no accounting issues, no trading issues, no reserve issues, no previously unknown problem issues." Compl. ¶ 344. At the outset, plaintiffs have failed to allege with particularity that Ken Lay's statement was false when made or that Lay had any knowledge of the alleged falsity. *See* Lay Mot. at II, V(C). But even if plaintiffs could overcome these insurmountable hurdles, Mr. Lay's general statements to the effect that there were "no problems" are too broad and general to be relied upon by a reasonable investor. *See Pacheco v. Cambridge Tech. Partners, Inc.*, 85 F. Supp. 2d 69, 80-81 (D. Mass. 2000) (CEO's statement that "There are not going to be any surprises" was puffery); *see also BMC Software*, 183 F. Supp. 2d at 892 (company's assertion that its troubles were temporary and behind it was inactionable as a "vague expression[] of optimism about the future in trying times"); *Kurtzman*, No. H-99-779, slip op. at 53 (noting that

---

[21] (...continued)
investors . . . Enron's stock price continued to decline").

market observers are "too familiar" with predictions that mergers will create synergies and that companies will be successfully integrated).[22]

E. Several of Lay's Comments Were Forward-Looking Statements Protected by the PSLRA Safe Harbor and the Bespeaks Caution Doctrine

The PSLRA provides a "safe harbor" for forward-looking statements.[23] *See* 15 U.S.C. § 78u-5. The "safe harbor" prevents plaintiffs from bringing claims based on forward-looking statements that are either: (1) "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statements"; or (2) "immaterial." 15 U.S.C. § 78u-5(c)(1)(A). The cautionary language need not appear after every single forward-looking statement; instead, it is sufficient for the meaningful cautionary language to be provided once per document or presentation. *Wenger*, 2 F. Supp. 2d at 1241. As an additional requirement, a plaintiff must also prove that the forward-looking statement was made or approved by an executive officer "with actual knowledge by that officer that the statement was false or misleading.[24]" 15 U.S.C. §§ 77z-2(c)(1)(B), 78u-5(c)(1)(B); *see, e.g., Harris v. IVAX Corp.*, 182

---

[22] For the same reason, Lay's alleged statement that he and Enron's Board of Directors continued to have the highest faith and confidence in Andrew Fastow also is inactionable puffery. *See Azurix*, 2002 WL 562819, at *14 ("A company's expressions of confidence in its management or business are not actionable").

[23] "Forward-looking statements" are defined as including: (i) "a statement containing a projection of revenues, income . . ., earnings . . . per share, capital expenditures, dividends, capital structure, or other financial items; (ii) "a statement of the plans and objectives of management for future operations"; (iii) "a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the [SEC]"; and (iv) "any statement of the assumptions underlying or relating to any statement described [above]." 15 U.S.C. § 78u-5(i)(1).

[24] For the reasons set forth in the scienter section of this brief (*see supra*, section II), (continued...)

F.3d 799, 803 (11th Cir. 1999) ("Even if the forward-looking statement has no accompanying cautionary language, the plaintiff must prove that the defendant made the statement with actual knowledge that it was false and misleading") (internal quotation omitted), *reh'g denied*, 209 F.3d 1275 (11th Cir. 2000).

While the PSLRA safe harbor requires inclusion of the cautionary language in the same document or presentation, the "bespeaks caution" doctrine examines the total mix of information available to investors. *In re Donald J. Trump Casino Sec. Litig. -- Taj Mahal Litig.*, 7 F.3d 357, 371 (3d Cir. 1993), *cert. denied*, 510 U.S. 1178 (1994). Courts therefore "have not required cautionary language to be in the same document as the alleged misrepresentation or omission" when applying the bespeaks caution doctrine. *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1122 (11th Cir. 1997). The bespeaks caution doctrine arises from the general requirement of materiality, and requires courts to read forward-looking statements in conjunction with cautionary language to determine the weight a reasonable investor would place on the forward-looking statement. *Rubenstein v. Collins*, 20 F.3d 160, 166-168 (5th Cir. 1994). The doctrine protects forward-looking statements where there was meaningful cautionary language publicly available in the marketplace at the time the statement was made. *Trump Casinos*, 7 F.3d at 371; *Grossman*, 120 F.3d at 1122.

Plaintiffs' alleged misrepresentations include several forward-looking statements by Ken Lay about the prospects of Enron's various business units and the company generally. Enron's public filings are replete with numerous specific warnings about the potential risks and uncertainties surrounding Enron's businesses. Because of the numerous meaningful cautionary warnings provided

---

[24] (...continued)
plaintiffs have not alleged properly that Lay made any of the alleged misrepresentations with actual knowledge the statement was false or misleading.

by Enron, Lay's forward-looking statements are protected under either the PSLRA safe harbor or the bespeaks caution doctrine. In this section, Mr. Lay's forward-looking statements have been categorized by business unit so that his statements may be viewed in light of the detailed disclosures made about each business unit.

1. Retail Energy Services

Lay allegedly made forward-looking statements about Enron Energy Services ("EES") in paragraphs 128, 174, 177, 196, 343.[25] The PSLRA safe harbor or the bespeaks caution doctrine protects all of these statements. For example, Lay allegedly said:

- Enron Corp. . . . is negotiating energy services contracts valued at about $22 billion, and may top its goal of signing $8 billion in agreements this year, Chairman Kenneth Lay said. "We fully expect to hit the $8 billion number and possibly exceed it," Lay said in an interview.[26] Compl. ¶ 174.
- "Our retail business is now profitable. This business has reached critical mass in contracting activity and service capabilities, and profitability is expected to accelerate rapidly." Compl. ¶ 196.

---

[25] Lay identifies the statements excerpted in this section and the portions of the following paragraphs as forward-looking statements about EES: ¶ 128 ("Enron Energy Services has advanced to a fully developed business . . . . We have experienced a strong market reception and very successful contracting results, and we are very pleased about the prospects for this dynamic business."); and ¶ 177 (entire quote by Lay).

[26] In paragraphs 168, 174, 212, 356, and 367, plaintiffs rely upon alleged misrepresentations in which third party sources (*e.g.* Bloomberg, etc.) purport to quote or paraphrase Lay. Because plaintiffs have made no allegations that Ken Lay had the opportunity to review the third party articles or otherwise had control over the content, these paragraphs should be dismissed. *See In re Newbridge Networks Sec. Litig.*, 926 F. Supp. 1163, 1171 (D. D.C. 1996) (plaintiff must allege defendants had some control over final version of article because the speaker might be quoted out of context); *In re Gupta Corp. Sec. Litig.*, 900 F. Supp. 1217, 1237 (N.D. Cal. 1994) (same). At a minimum, the paraphrased statements attributed to Lay should be rejected. *See BMC Software*, 183 F. Supp. 2d at 914 n.51 (noting that extensive paraphrasing "is a significant factor in this action that diminishes the strength of plaintiffs' claim that they have met their pleading burden").

- "We expect [EES] to continue to grow very, very strong . . . [T]he company believe[s] that the Enron Energy Services component could become as large or larger than Enron's wholesale business within a five or six year period or so." Compl. ¶ 343.

The bespeaks caution doctrine protects Lay's forward-looking statements about EES. In its 10-K and 10-Q filings, Enron repeatedly warned potential investors that "[i]mportant factors . . . could cause actual results to differ materially from those in the forward-looking statements herein," including Enron's ability "to penetrate new retail natural gas and electricity markets in the United States and Europe; the timing and extent of deregulation of energy markets in the United States and in foreign jurisdictions; other regulatory developments in the United States and in foreign countries, including tax legislation and regulations; the extent of efforts by governments to privatize natural gas and electric utilities and other industries."[27] Beginning in 2000, Enron further cautioned investors that results were dependent upon "the effectiveness of Enron's risk management activities; [and] the ability of counterparties to financial risk management instruments and other contracts with Enron to meet their financial commitments to Enron."[28] When Ken Lay's statements are considered in conjunction with Enron's specific cautionary language, any reasonable investor would have realized that Lay's forward-looking statements were subject to many potential uncertainties.[29] *See Parnes*

---

[27] Master SEC App., tab 6, Enron 10-K (year ending Dec. 31, 1998), at 69-70; Master SEC App., tab 10, Enron 10-K (year ending Dec. 31, 1999), at 53-57.

[28] *See, e.g.*, Master SEC App., tab 15, Enron 10-K (year ending Dec. 31, 2000), at 52.

[29] Enron also repeatedly disclosed that it would provide up-front capital to design, build and finance EES projects, and that EES revenue was accounted with mark-to-market accounting. Master SEC App., tab 1, Enron 10-K (year ending Dec. 31, 1996), at 70-71; Master SEC App., tab 2, Enron 10-K (year ending Dec. 31, 1997), at 76; Master SEC App., tab 6, Enron 10-K (year ending Dec. 31, 1998), at 85; Master SEC App., tab 10, Enron 10-K (year ending Dec. 31, 1999), at 73; Master SEC App., tab 15, Enron 10-K (year ending Dec. 31, 2000), at 68. The market was well aware that EES's contract announcements represented projected future revenue over the life of the

(continued...)

v. Gateway 2000, Inc., 122 F.3d 539, 549 (8th Cir. 1997) (warning that there was no assurance new product would be successful meant "no reasonable investor could have been misled that Gateway's new portable products, which represented a small fraction of Gateway's total sales, were anything but a risky venture"). Plaintiffs' claims relating to Mr. Lay's forward-looking statements about EES therefore should be dismissed.

2. Enron's Broadband Unit

Ken Lay allegedly made similar forward-looking statements relating to Enron's Broadband business unit ("EBS") in paragraphs 168, 196, 212, 215, and 241. Lay's statements made in connection with Enron's January 18, 2000, earnings report for 1999 are protected by the PSLRA safe harbor, while the bespeaks caution doctrine applies to the remaining statements.[30] For example, Mr. Lay allegedly said:

- "Bandwidth trading could provide us with our highest potential growth," said Lay. Enron expects the market for trading space on fiber optic networks to more than triple to $95 billion per year by 2004. The company hopes to capture 10-20% of that revenue, Lay told analysts. Compl. ¶ 212.

---

[29] (...continued)
contract. *See, e.g.*, Master App., tab 21, at 4 and tab 16, at 6-7. Plaintiffs therefore cannot show that Lay's projection of $8 billion in contract signings was false or misleading.

[30] Lay identifies the statements excerpted in this section and the following portions of these paragraphs as forward-looking statements about EBS: ¶ 168 (The company will get an added kick in earnings from another rapidly growing market -- fiber optic bandwidth trading, he added . . . . Enron now owns 9,500 miles of Internet Protocol fiber-optic in its U.S. network, Lay said. . . . All of it should be operational by next year.); ¶ 196 ("In addition, Enron continues to develop innovative, high-growth new businesses that capitalizes on our core skills, as demonstrated by the early success of our new broadband services business."); ¶ 215 ("Our new broadband subsidiary, Enron Broadband Services, is redefining Internet performance by designing and supplying a full range of premium broadband delivery services . . . . We believe that our broad networks will give us unbeatable scale and scope in every business in every region in which we operate."); and ¶ 241 (entire paragraph).

- "The market for bandwidth intermediation will grow from $30 billion in 2000 to $95 billion in 2004. With our head start, we expect to become a leader in this field." Compl. ¶ 215.

The bespeaks caution doctrine applies to the above statements about EBS, because Enron's public filings provided meaningful cautionary language warning about the potential obstacles in the broadband market. Indeed, Enron not only provided general cautionary language about forward-looking statements, but also provided specific warnings that a market for bandwidth trading and broadband services might never materialize.[31] Enron also disclosed to the market that EBS was a start-up company that was incurring growing losses.[32] Based on Enron's disclosures, any reasonable investor would have realized that Ken Lay's alleged statements were forward-looking statements about a risky venture. *See Parnes*, 122 F.3d at 548-49. Thus, the Court should dismiss plaintiffs' claims relating to Ken Lay's forward-looking statements about EBS.

---

[31] Master SEC App., tab 10, Enron 10-K (year ending Dec. 31, 1999), at 17; Master SEC App., tab 12, Enron Form 10-Q (period ending March 31, 2000), at 25; Master SEC App., tab 13, Enron Form 10-Q (period ending June 30, 2000), at 30-31; Master SEC App., tab 14, Enron Form 10-Q (period ending September 30, 2000), at 33; Master SEC App., tab 15, Enron 10-K (year ending Dec. 31, 2000), at 15-16; Master SEC App., tab 17, Enron Form 10-Q (period ending March 31, 2001), at 29; Master SEC App., tab 18, Enron Form 10-Q (period ending June 30, 2001), at 34; Master SEC App., tab 19, Enron Form 10-Q (period ending Sept. 30, 2001), at 73.

[32] *See* Master SEC App., tab 13, Enron Form 10-Q (period ending June 30, 2000), at 21-22 (loss before interest, minority interests and taxes for first half of 2000 of $8 million); Master SEC App., tab 14, Enron Form 10-Q (period ending September 30, 2000), at 22-23, 29 ($20 million loss in third quarter of 2000 and $28 million loss for first nine months of 2000); Master SEC App., tab 15, Enron 10-K (period ending Dec. 31, 2000), at 43 ($60 million loss for year 2000); Master SEC App., tab 17, Enron Form 10-Q (period ending March 31, 2001), at 23 ($35 million loss in first quarter of 2001); Master SEC App., tab 18, Enron Form 10-Q (period ending June 30, 2001), at 22-23 ($102 million loss for first half of 2001).

3. Enron's International Water Business

Ken Lay allegedly made the following forward-looking statements about Enron's investment in the international water business:[33]

- "The new company is expected to be accretive to Enron's financial results in the first full year of operations, and we intend to pursue a strategy such that the new water company will be accretive in the future . . . . Wessex will be the flagship of the new water company. As such, Wessex will be the center of excellence for the new international water business." Compl. ¶ 114.

- Ken Lay . . . said in an interview he expects the new company to become "the leading global water company." He expects the water business to be of comparable size to Enron's multibillion dollar electricity and gas businesses "within five years or so." Compl. ¶ 115.

Mr. Lay's forward-looking statement quoted in paragraph 114 of the complaint should be dismissed because it falls within the safe harbor of the PSLRA. In the very same document quoted by plaintiffs, Enron noted that the press release contains forward-looking statements and disclosed that actual results may differ materially because of "political and regulatory developments affecting Wessex, the level of Wessex's capital expenditures, the availability of new acquisition opportunities, the timing and success of future acquisitions and conditions of the capital markets and equity markets." Master SEC App., tab 10. The press release further warned potential investors that the acquisition of Wessex would not necessarily increase Enron's earnings per share. *Id.* Based on the

---

[33] As a threshold matter, Judge Lake already has addressed and dismissed substantially similar statements about Enron's water business made in connection with the Azurix IPO approximately one year after Lay's alleged statements. *See Azurix*, 2002 WL 562819, at *3-4, 14-15 (dismissing complaint that included alleged misrepresentations that Azurix had "many growth opportunities that will distinguish the company as a leading player in the global water industry" and that Azurix's earnings would approximate $500 million in the year 2000 and $800 million in 2001, among other alleged misrepresentations). Lay's alleged statements about Enron's water business were also made before the beginning of the class period, which renders them inactionable. *Supra*, section V(A).

specific disclosures in the July 24, 1998 press release, Ken Lay's alleged statement quoted in paragraph 114 of the complaint plainly falls within the protection of the PSLRA's safe harbor. Similarly, Lay's alleged statement in paragraph 115 of the complaint was made the same day as the July 24, 1998 press release, and should therefore be dismissed under the bespeaks caution doctrine. *Atkins v. Hibernia Corp.*, 182 F.3d 320, 326 (5th Cir. 1999) (no securities violation where public filing discloses the information material to the alleged misrepresentation or omission).

4. Other Forward-looking Statements

In paragraphs 168, 177, 215, 293, 343, 364, 368, and 369 of their complaint, plaintiffs allege that Ken Lay made forward-looking statements relating to Enron's wholesale business or to Enron's potential future performance.[34] For example, Lay allegedly said:

---

[34] Lay identifies the statements excerpted in this section and the following portions of these paragraphs as forward-looking statements: ¶ 168 (Continued growth in Enron Corp.'s core businesses will help the company maintain strong earnings growth in the coming years, the company's chairman and chief executive officer said Tuesday.); ¶ 177 ("The scale and scope of Enron's wholesale businesses provide tremendous competitive advantages in the rapidly growing, deregulating energy markets, enabling Enron to consistently achieve strong earnings growth."); ¶ 215 ("We believe the future will be even more rewarding. We remain the world's leader in wholesale and retail energy services."); ¶ 293 ("Enron has built unique and strong businesses that have tremendous opportunities for growth. These businesses . . . can be significantly expanded within their very large existing markets and extended to new markets with enormous growth potential. At a minimum, we see our market opportunities company-wide tripling over the next five years . . . . Enron is laser-focused on earnings per share, and we expect to continue strong earnings performance. "); ¶ 343 ("There were no changes in Enron's earnings outlook. . . . [T]he company is on solid footing and was looking forward to continued strong growth. . . . If anything, there seems to be even a little acceleration in the company's both financial performance and operational performance. . . . I see absolutely no change in our business direction or our business strategy." "The company is very strong, we have very deep talent, very broad talent and we think, in fact, there should be no change in the performance or the outlook for the company going forward."); ¶ 364 ("The continued excellent prospects in these businesses Enron's leading market position make us very confident in our strong earnings outlook."); ¶ 368 ("And we try to clean all those [items for which there were charges] up in this quarter since they seemed to be providing quite a bit of distraction to the real quality and strong growth of our core businesses." "And you're right, I mean, we reconfirmed our earnings for (continued...)

- "The scale and scope of Enron's wholesale businesses provide tremendous competitive advantages in the rapidly growing, deregulating energy markets, enabling Enron to consistently achieve strong earnings growth." Compl. ¶ 177.

- "The best time for the succession to occur is when the company is doing well," said Lay, who said revenue could top $90 billion this year, up from about $40 billion in 1999. Compl. ¶ 275.

- "Enron is laser-focused on earnings per share, and we expect to continue strong earnings performance." Compl. ¶ 293.

- "If we thought there were any other significant concerns, we would have taken care of them today," Lay said.[35] Compl. ¶ 367.

Where plaintiffs have quoted from Enron's public filings (*see* Compl. ¶¶ 177, 215, and 293), Mr. Lay's statements are protected by the PSLRA's safe harbor because Enron provided meaningful cautionary language about all of its business lines, including the wholesale business.[36] Enron further disclosed the accounting treatments about which plaintiffs complain and the risks inherent in such

---

[34] (...continued)
19 - or 2001 at $1.80, which is what the Street expects, and $2.15 for next year. So it will be one more year of about 20 percent growth in earnings per share."); and ¶ 369 ("Next year looks good. We did reconfirm in our earnings release this morning that we expect to hit the fourth quarter numbers that we have been projecting and $1.80 for this year and $2.15 next year. So, again, about another 20 percent growth in earnings per share for next year.").

[35] Plaintiffs cite an October 16, 2001, Bloomberg article and claim, based on this quote, that Lay denied Enron would be taking additional large charges. At the conference call on the same day, Lay was asked a similar question and responded: "If we thought we had any other impaired assets, it would be in this list today. But we do still have at least three areas of uncertainty in the company, which you're aware of." Lay App., tab 7, at 15. Mr. Lay then proceeded to discuss potential uncertainties regarding the regulatory situation in California, the situation in India, and Enron's broadband business. *Id.* Plaintiffs' quote is therefore misleadingly incomplete because it does not reflect the actual information made available to the market that same day.

[36] For Enron's disclosures regarding its retail and broadband divisions, see *supra* section V(E)(1) and (2). Enron also provided meaningful cautionary language regarding its wholesale division. *See* Master SEC App., tab 6, Enron 10-K (period ending Dec. 31, 1998), at 53; Master SEC App., tab 10, Enron 10-K (period ending Dec. 31, 1999), at 47; Master SEC App., tab 15, Enron 10-K (period ending Dec. 31, 2000), at 38-39.

treatments.[37] Because Lay's other statements must be read in conjunction with the public disclosures made by Enron, his other statements are protected by the bespeaks caution doctrine.

F. Ken Lay's Statements of Historical Facts Are Not Actionable Because Such Statements Are Not Material to the Stock Price

The reciting of past results is "per se immaterial," because it would be unreasonable for an investor to interpret a statement about past results as a representation about future results. *See In re Boston Tech. Inc. Sec. Litig.*, 8 F. Supp. 2d 43, 54 (D. Mass. 1998); *see also Serabian v. Amoskeag Bank Shares, Inc.*, 24 F.3d 357, 361 (1st Cir. 1994) ("defendants may not be held liable under the securities laws for accurate reports of past successes, even if present circumstances are less rosy"). Further, to qualify as material, information must significantly alter the total mix of information available to the market, *see Azurix*, 2002 WL 562819, at *12 (quoting *Basic, Inc. v. Levinson*, 485

---

[37] For example, Enron made detailed disclosures about the following:

Off Balance Sheet Debt: Master SEC App., tab 16, Enron Annual Report (period ending Dec. 31, 2000), at 41 n.7 ($1.9 billion for Convertible Senior Notes), 41-42 n.8 ¶¶ 3-5 (Minority Interests totaling $1.75 billion), 43 n.10 (Whitewing, $2.428 billion, calculated by multiplying 250,000 preferred shares times conversion rate of 200, and then multiplying by $48.55 settlement price), 43 n.10 (Azurix, $1.2 billion), 44 n.11 (several billion in Derivative Instrument Obligations), 48 n.15 (several billion in guarantees and other commitments).

Related-Party Transactions: Master SEC App., tab 10, Enron 10-K (period ending Dec. 31, 1999), at 56-58; Master SEC App., tab 21, Enron 2000 Annual Proxy, at 29-30; Master SEC App., tab 15, Enron 10-K (period ending Dec. 31, 2000), at 52-54, 95-96; Master SEC App., tab 22, Enron 2001 Annual Proxy, at 28-31.

Mark-to-Market Accounting: Master SEC App., tab 10, Enron 10-K (period ending Dec. 31, 1999), at 78-82; Master SEC App., tab 15, Enron 10-K (period ending Dec. 31, 2000), at 75-76.

"Snowballing," or the capitalizing of project expenses: Master SEC App., tab 3, Enron Form 10-Q (period ending Mar. 31, 1998), at 21; Master SEC App., tab 5, Enron Form 10-Q (period ending Sept. 30, 1998), at 38.

U.S. 224, 232 (1988)), but the recitation of past results already priced into the market does absolutely nothing to change the total mix of available information. In the following alleged misrepresentations, Lay's statements were simply reciting past historical facts that were already priced into the market:[38]

> "You can go back over a ten-year period, the income before interest and taxes has, in fact, been increasing at about 30% per year, compounded and that growth has been stronger in the last couple of years as you also know . . . Retail or Enron Energy Services, of course, in recent, fairly new business, only started about five years ago . . . but in that business, over the last two or three years, we have been doubling revenue and doubling income quarter-on-quarter, year-on-year for now about the last three years." Compl. ¶ 343.

> "Over the last four or five years, we've been growing at a 20 percent compound annual rate as far as earnings per share. Third quarter this year, our net income was up over - or , up 40 percent, and earnings per share increase was about 32 percent, so the company's growing at a very rapid rate." Compl. ¶ 356.

The continued decline of Enron's stock price at the time Ken Lay was making the above statements further underscores the immateriality of Lay's alleged statements. In fact, plaintiffs repeatedly criticize Lay and others for *unsuccessfully* attempting to support the stock price. *See* Compl. ¶ 342 ("Despite the efforts . . . to support Enron's stock during 5/01-7/01, it continued to erode"), ¶ 360 ("While Enron . . . made a valiant effort during the last half of 8/01 and 9/01 to assure investors . . . Enron's stock price continued to decline"). By doing so, plaintiffs effectively concede that Ken Lay's statements were not material because Enron's stock price continued to decline. Plaintiffs' allegations regarding Lay's statements reciting past historical facts therefore should be dismissed.[39]

---

[38] Plaintiffs also have not made any specific allegations showing that Lay's statements were false when made or that Lay knew such statements were false when made.

[39] Alternatively, to the extent the statements are viewed as "mixed" statements containing both historical comments and future predictions, the statements should be dismissed for the reasons (continued...)

G. Plaintiffs Have Not Alleged Sufficiently that Lay's Alleged Statement to Employees Was a Public Statement

For one of their alleged misrepresentations, plaintiffs rely on an e-mail Lay allegedly sent to Enron employees on August 14, 2001. Compl. ¶ 343. In the e-mail, Mr. Lay allegedly wrote "Our performance has never been stronger; our business model has never been more robust; our growth has never been more certain." *Id.* Plaintiffs allege without further explanation that the e-mail "immediately became public." *Id.*

Because plaintiffs premise their claims on a fraud-on-the-market theory, they must allege, among other things, that Ken Lay made a *public* misrepresentation. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 248 n.27 (1988) (listing the various elements plaintiffs must plead and prove to maintain fraud-on-the-market presumption). Lay's alleged e-mail to employees is not actionable due to plaintiffs' failure to allege properly that Lay made a public statement.

First, plaintiffs have failed to allege that Lay intended for the e-mail to become public. "Fundamental to every case applying the fraud on the market theory is that defendants made the fraudulent misrepresentation *with the intent* that the false information reach the market so as to affect the stock's price." *In re Gulf Oil/Cities Service Tender Offer Litig.*, 725 F. Supp. 712, 752 (S.D. N.Y. 1989) (emphasis added). Plaintiffs' complaint is completely silent on the issue of Lay's intent. Nor does plaintiffs' allegation that the e-mail became public have any relevance to Lay's intent when

---

[39] (...continued)
set forth in section V(E), *supra*. *See Kurtzman v. Compaq Computer, Corp.*, No. H-99-779, slip op. at 59 n.17 (S.D. Tex. Mar. 30, 2002) ("Where a statement is 'mixed,' . . . the whole statement is viewed as forward-looking.").

he sent the e-mail. For this reason alone, plaintiffs' alleged misrepresentation based on Lay's e-mail to employees should be dismissed.[40]

Further, plaintiffs' allegation that the e-mail "immediately became public" is too vague and conclusory to support a claim. *See Collins v. Morgan Stanley Dean Witter*, 224 F.3d 496, 498 (5th Cir. 2000) ("We will . . . not accept as true conclusory allegations or unwarranted deductions of fact.) (quoting *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994)). "The theme of *Basic* and other fraud-on-the-market decisions is that *public* information reaches professional investors, whose evaluations of that information and trades quickly influence securities prices." *West v. Prudential Sec. Inc.*, 282 F.3d 935, 937 (7th Cir. 2002). In the context of statements to analysts, plaintiffs must show that analyst conversations were relayed to the market in an analyst report or by other means. *In re Cirrus Logic Sec. Litig.*, 946 F. Supp. 1446, 1468 (N.D. Cal. 1996) (citing *Basic*, 485 U.S. at 248 n.27). By analogy, plaintiffs here also should have to show that Lay's e-mail was communicated to money managers and professional investors. Because plaintiffs have made no such specific allegations, plaintiffs' complaint offers no explanation for how an e-mail sent to Enron employees reached professional investors and money managers. *Cf. West*, 282 F.3d at 938 (finding broker's communications with handful of clients not actionable and noting that "[n]o similar [price adjustment] mechanism explains how prices would respond to non-public information"). A mere conclusory allegation that the information became public is insufficient to establish that Ken Lay's e-mail reached the market.[41]

---

[40] Lay's e-mail also constitutes inactionable puffery. *See supra*, section V(D).

[41] Unable to allege any specific facts establishing that Ken Lay made material misrepresentations to investors, plaintiffs themselves misrepresent his exercise of his Fifth (continued...)

VI. Plaintiffs Have Not Pleaded a Control Person Liability Claim Against Mr. Lay

Plaintiffs also claim that Ken Lay is liable for the alleged misrepresentations and omissions set forth in their complaint under a theory of control person liability pursuant to § 20(a) of the Securities Exchange Act of 1934. *See* Compl. ¶¶ 992-97. Plaintiffs' pleading of control person liability against Mr. Lay, however, is fatally flawed.

To begin with, plaintiffs have not alleged who or what it is they claim that Mr. Lay controlled. The complaint does not inform Lay whether he allegedly controlled Enron, its officers, its directors, some other defendant identified in the complaint, or some combination of all of the above. Plaintiffs' complaint merely identifies those defendants against whom control person liability is alleged without explaining who allegedly controlled whom. They do not set forth the elements of their 20(a) cause of action or allege, even in general terms, how those elements are satisfied as to Mr. Lay. For this reason, the control person allegations must be dismissed.

If plaintiffs are claiming that Mr. Lay controlled Enron, their claims must be dismissed for the additional reason that plaintiffs have not properly pleaded a primary violation by Enron, as set forth in Certain Defendants' Joint Brief Relating to Enron's Disclosures ("Joint Brief"). In order to plead control person liability, a plaintiff must first properly plead a primary violation of § 10(b). *Thornton*, 878 F. Supp. at 938. Where, as here, the plaintiffs have failed to plead a primary violation, the court must dismiss the § 20(a) claim. *Thornton*, 878 F. Supp. at 938.

---

[41] (...continued)
Amendment rights before Congress as an assertion that his testimony would incriminate him. Compl. ¶ 392. The United States Supreme Court has made exceedingly clear, however, that the Fifth Amendment privilege against self-incrimination "protects the innocent as well as the guilty." *Ohio v. Reiner*, 532 U.S. 17, 18 (2001). Mr. Lay stated as much when he appeared before Congress and plaintiffs' attempt to twist his invocation of his Constitutional rights into an inference of misconduct is both unseemly and inappropriate.

Even assuming that plaintiffs have pleaded a primary violation against Enron, they have not pleaded sufficient allegations of control as to Mr. Lay. To plead control person liability plaintiffs must plead *facts* indicating that: (1) Lay actually exercised control over the operations of the controlled person or entity, generally; and (2) Lay possessed the power to control the specific transactions or activities upon which the primary violation is predicated. *See Abbott v. Equity Group, Inc.*, 2 F.3d 613, 620 (5th Cir. 1993), *cert. denied*, 510 U.S. 1177 (1994); *see also Lane Hartman Ltd. v. P.R.O. Missions, Inc.*, No. 3:95-CV-0869, 1997 WL 457512, at *4 (N.D. Tex. Aug. 5, 1997). The plaintiffs must plead the circumstances of control with particularity. *Splash Tech.*, 2000 WL 1727377, at *25. Pleading control person liability in conclusory fashion is inadequate. *Rich v. Maidstone Fin., Inc.*, No. 98-CIV-2569, 2001 WL 286757, at *9 (S.D.N.Y. Mar. 23, 2001). The complaint must allege *facts* from which it can be inferred that the defendant had the authority to control the allegedly controlled person or entity. *Id.*

Plaintiffs allege that Ken Lay was a director of Enron, chairman of the board, and chief executive officer "at various times" during the class period. Compl. ¶ 83(a). They also allege that he was CEO from 1986 until February 2001 and from August 2001 through the end of the class period. *Id.* "[T]he issue of control person liability [however,] cannot hinge merely upon a party's position and title." *Lane Hartman Ltd.*, 1997 WL 457512, at *5; *see also Rich*, 2001 WL 286757, at *9 ("[P]leading officer or director status alone is not enough.").

The plaintiffs fail to plead with particularity facts from which it can be inferred that Lay had "the power to control the specific transaction or activity upon which the primary violation is predicated." *See Abbott*, 2 F.3d at 620 (quoting *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985)). In *Paracor Finance, Inc. v. General Elec. Capital Corp.*, 96 F.3d 1151, 1163-64 (9th Cir.

1996), the Ninth Circuit held that a CEO was not liable as a control person because there was no evidence that he exercised control over the debenture offering upon which the primary violation was based. The CEO was not authorized by the board of directors to act for the company in connection with the debenture offering, even though other officers of the corporation were so authorized. *Paracor*, 96 F.3d at 1163. Moreover, although he knew about the offering, the CEO did not participate in preparing or reviewing the offering materials. *Id.* at 1163-64. Rather, he relied on another senior officer to review the offering materials. *Id.* at 1163. As a result, although there was evidence that the CEO was involved in the management of the company (because he was consulted on every major decision), there was no evidence that he exercised control over the debenture offering. *Id.* at 1163-64.

In a corporation the size of Enron -- with over 20,000 employees and operations in five continents -- it is simply not reasonable to assume that Mr. Lay, by virtue of his position at times during the class period as CEO, possessed the power to control each and every specific transaction and activity engaged in by the company and its employees. *See,* Master SEC App., tab 15, Enron 10-K (year ending Dec. 31, 2000) at 1, 5, 12. Plaintiffs have failed to meet their burden to plead facts supporting an inference that Lay controlled the transactions and activities that are the basis of their complaint. Plaintiffs have not pleaded, for example, that Mr. Lay was the member of management responsible for the LJM relationship. Nor have they pleaded that Lay had the power to control Enron's accounting decisions relating to its treatment of revenues and expenses in connection with its various business units. The plaintiffs have also not pleaded facts indicating that Lay controlled the disclosure of related party transactions or facts demonstrating that he actually participated in the preparation of Enron's SEC filings.[42] As a result of their failure to plead facts specifically linking Lay's management responsibilities to the misrepresentations complained of, plaintiffs' § 20(a) claim must be dismissed.

VII. Plaintiffs Cannot Prevail on Their Texas Securities Act Claim

Plaintiffs' own pleadings preclude their claim under the Texas Securities Act ("TSA"). Plaintiffs purport to create a "Note Subclass," represented by Washington Board, allegedly related to two note offerings. Compl. ¶¶ 1018,1020. The putative Note Subclass alleges it was induced to purchase the notes based on a "Registration Statement and Prospectus" containing material misrepresentations and/or omissions. *Id.* ¶ 1020.

But these allegations are fatal. The Registration Statement is dated December 31, 1997 (Master SEC App., tab 83, at 1), and was supplemented on July 7, 1998 (Master SEC App., tab 82, at 2) - - months before the beginning of the October 1998 class period. Compl. ¶ 121. As a matter of law, any alleged misrepresentations made before the class period cannot support a claim for securities fraud. *In re International Bus. Machines Corp. Sec. Litig.*, 163 F.3d 102, 107 (2d Cir. 1998) (representations made one day before the class period are not actionable; "a defendant . . . is liable only for those statements made during the class period"); *see In re Clearly Canadian Sec. Litig.*, 875 F. Supp. 1410, 1420 (N.D. Cal. 1995).

Even if the alleged misrepresentations had been made during the class period, they would have been made after plaintiffs allegedly purchased the notes, conclusively negating any claim that a misrepresentation induced the alleged purchases. Plaintiffs cite no new facts in their claim under the

---

[42] Conclusory allegations of control and legal conclusions such as those contained in ¶ 397 of plaintiffs' amended complaint are insufficient to plead control. *Rich*, 2001 WL 286757, at *9.

Texas Securities Act, relying instead on the 1016 paragraphs preceding that claim. Compl. ¶ 1017. But virtually all of those allegations relate to alleged misconduct during the putative class period, beginning in October 1998, and plaintiffs fail to explain how any alleged misrepresentations relate to the two note offerings.[43] If plaintiffs had purchased these notes in July 1998 (as they allege), the purchases necessarily would have predated the alleged misrepresentations, and therefore could not have been induced "by means of" a misrepresentation or omission. TEX. REV. CIV. STAT. ANN. art. 581-33A2 (Vernon Supp. 2001); *Crescendo Invs., Inc. v. Brice*, 61 S.W.3d 465, 475 (Tex. App. - - San Antonio 2001, pet. denied) ("A statement made after purchase of the securities could not induce purchase and is therefore not relevant."); *see also In re Westcap Enters.*, 230 F.3d 717, 726 n.11 (5th Cir. 2000) (noting that the Texas Securities "Act speaks exclusively to liability for *sales* of a security," and citing other authority for the proposition that "plaintiff must show the untrue statements were made before the sale occurred."). Consequently, this claim must be dismissed.

Plaintiff cannot prevail on their claim for relief under the TSA for the additional reason that they have not alleged -- nor can they prove -- that Mr. Lay offered or sold securities to them. Article 581-33A(2) states, in relevant part:

> A person who *offers or sells* a security . . . by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, *is liable to the person buying the security from him* . . . .

TEX. REV. CIV. STAT. ANN. art. 581-33A(2) (Vernon Supp. 2001) (emphasis added).

"[This] is a privity provision, allowing a buyer to recover from his offeror or seller." TEX. REV. CIV. STAT. ANN. art. 581-33 cmt. The relevant phrase "person who offers or sells" is taken

---

[43] For this reason, the TSA pleadings also fail to comply with Rule 9(b). *See Williams v. WMX Technologies, Inc.*, 112 F.3d 175, 177 (5th Cir. 1997)

from federal law and is intended to have the same meaning. *Id.* The federal counterpart of Article 581-33A(2),[44] which is found in § 12(2) of the Securities Act of 1933, imposes a similar requirement, allowing buyers to recover only from their immediate sellers and those who solicit the transaction for their own financial gain, such as a stockbroker who recommends a purchase in hopes of receiving a commission. *See Pinter v. Dahl*, 486 U.S. 622, 643-45 & n.21 (1988); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1113-15 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989). Remote purchasers are precluded from bringing actions against remote sellers. *Pinter*, 486 U.S. at 643 n.21. The same limitations apply to a claim brought under the TSA. *See Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 383 (Tex. App. -- Houston [14th Dist.] 2000, writ denied) (noting that commentary at time of amendments to TSA left "little doubt that the revision was intended to contain a privity provision," thereby undermining reliance on Texas Supreme Court case predating amendments which adopted broad definition of "seller"); *see also Harding Univ. v. Consulting Services Group, L.P.*, 22 F. Supp. 2d 824, 830 (N.D. Ill. 1998) (interpreting TSA and dismissing complaint because defendant was not an offeror or seller of security in question).

Plaintiffs here purport to bring a TSA claim on behalf of all purchasers of Enron 6.95% notes due July 15, 2028 and Enron 6.40% notes due July 15, 2006 (the "Notes"). Plaintiffs allege that Mr. Lay drafted, revised, approved, signed and/or finalized the Registration Statement and Prospectus for the Notes. Compl. ¶¶ 1024(a) & (b). The Supreme Court has noted "§ 12's failure to impose

---

[44] Section 12(2) provides that any person who "offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading . . . shall be liable to the person purchasing such security from him." *See* 15 U.S.C. § 771(2). The wording of Article 581-33A(2), quoted herein, is virtually identical.

express liability for mere participation in unlawful sales transactions." *Pinter*, 486 U.S. at 650. At least three courts have held that allegations virtually identical to plaintiffs' allegations here were insufficient to confer liability under § 12. *See In re Azurix Corp. Sec. Litig.*, No. H-00-4034, 2002 WL 562819, at *25 (S.D. Tex. Mar. 21, 2002) (holding that § 12 "not satisfied by allegations that defendants were involved in preparing the registration statement or prospectus or any other activities necessary to effect the sale of the securities to the public"); *In re Cendant Corp. Sec. Litig.*, 190 F.R.D. 331, 339 (D.N.J. 1999) (holding that signing of registration statement and prospectus was insufficient for § 12 liability); *Persky v. Turley*, Nos. CIV-88-1830 and 88-2089, 1991 WL 327434, at *8 (D. Ariz. Dec. 19, 1991) (interpreting Arizona statute according to federal principles, and holding that allegations defendants drafted, filed and/or signed registration statements and prospectuses were insufficient because "active participation, not mere participation, must be sufficiently alleged . . . under section 12(2)").

To state a valid TSA claim, plaintiffs must therefore allege Mr. Lay's active participation in the sale of the notes. Plaintiffs must also allege that Lay had a financial motivation to solicit the sale of the notes, *see Pinter*, 486 U.S. at 647. Nevertheless, they have failed to plead Lay's active participation and to make any allegations relating to financial motivation. For both these reasons, plaintiffs' TSA claim should be dismissed.[45]

---

[45] Moreover, for the reasons set forth in section V(D) of this motion, plaintiffs' TSA claim should be dismissed because Mr. Lay's alleged misrepresentations were not material and/or were puffery. *See In re Westcap Enter.*, 230 F.3d 717, 726 (5th Cir. 2000) (looking to federal materiality cases to interpret TSA "[b]ecause the Texas Securities Act is so similar to the federal Securities Exchange Act, Texas courts look for decisions of the federal courts to aid in the interpretation of the Texas Act") (quoting *Grotjohn Precise Connexiones Int'l v. JEM Fin., Inc.*, 12 S.W.3d 859, 868 (Tex. App. -- Texarkana 2000, no writ)).

Plaintiffs also claim that Ken Lay and others "by virtue of their positions as directors and/or senior officers of Enron directly or indirectly controlled Enron and/or other defendants named in this claim." For the reasons set forth in Section III, however, plaintiffs' claim for control person liability under the Texas Securities Act is insufficient and must be dismissed. *See Lane Hartman Ltd.*, 1997 WL 457512, at *4 (explaining that courts may look to the standard for establishing control person liability under federal securities statutes in determining whether such liability exists pursuant to the Texas Securities Act).

Finally, the Court should dismiss the plaintiffs' Texas Securities Act claims pursuant to 28 U.S.C. § 1367(c)(3), which states that the Court may dismiss state law claims when it has dismissed all claims over which it has original jurisdiction. *See also Calliott*, 2000 WL 351753, at *9. Plaintiffs have failed to adequately plead a federal securities law claim. As a result, the Court may decline to exercise jurisdiction over plaintiffs' state law claims.

VIII. The Plaintiffs Have Not Pleaded a § 11 or § 15 Claim Against Mr. Lay

Plaintiffs claim that Mr. Lay is responsible for alleged misrepresentations contained in four registration statements and prospectuses pursuant to §§ 11 and 15 of the Securities Act of 1933.[46] *See* Compl. ¶¶ 1005-11. Section 11 imposes liability if a registration statement contains an untrue statement of a material fact or omits to state a material fact required to be stated therein. 15 U.S.C. § 77k(a)(1).

[46] This claim is based solely on allegations of negligence and/or strict liability. Plaintiffs expressly disclaimed any allegation that could be construed as alleging fraud or intentional recklessness. Compl. ¶ 1005.

As explained above and in the Joint Brief, the misrepresentations alleged by the plaintiffs were not "material" or otherwise actionable. As a result, plaintiffs' § 11 claims based on those representations must fail.

Moreover, the § 11 claims should be dismissed because the plaintiffs fail to allege facts indicating that they purchased Enron securities in the initial public offering ("IPO"). *See Azurix*, 2002 WL 562819, at *25-26 (identifying as one element of a § 11 claim the fact that plaintiffs purchased their shares in the IPO). Plaintiffs, however, plead only that they purchased Enron securities "traceable" to a registration statement. *See* Compl. ¶¶ 1014-15. This is insufficient to state a § 11 claim. *See Azurix*, 2002 WL 562819, at *25-26.

Finally, Plaintiffs' § 15 control person claim must also be dismissed for the reasons set forth above in Section VI above. *See BMC Software*, 183 F. Supp. 2d at 867 n.17 ("Although worded in different ways, the control person liability provisions of § 15 and of the 1933 Securities Act and § 20(a) of the 1934 Exchange Act are interpreted the same way.") (citations omitted). Absent a primary violation, there can be no control person liability.

IX. Conclusion

For the reasons set forth above, Ken Lay respectfully requests that plaintiffs' claims against him be dismissed in their entirety with prejudice.

Respectfully submitted,

James E. Coleman, Jr. (BC)

James E. Coleman, Jr.
State Bar No. 0457400
Southern District ID No. 04574000
CARRINGTON, COLEMAN, SLOMAN
& BLUMENTHAL, L.L.P.
200 Crescent Court, Suite 1500
Dallas, Texas 75201
(214) 855-3000 (telephone)
(214) 855-1333 (telecopy)

ATTORNEY IN CHARGE FOR
DEFENDANT KENNETH L. LAY

OF COUNSEL:

Bruce W. Collins
State Bar No. 04604700
Southern District ID No. 20110
Sharon J. Shumway
State Bar No. 00791660
Southern District ID No. 30561
Carrington, Coleman, Sloman & Blumenthal, L.L.P.
200 Crescent Court, Suite 1500
Dallas, Texas 75201
(214) 855-3000 (telephone)
(214) 855-1333 (telecopy)

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing instrument was served upon the attorneys of record of all parties as per the attached Exhibit A in accordance with the Court's Order of April 4, 2002, and Rule 5, Federal Rules of Civil Procedure, on this 8th day of May, 2002.

Bruce W. Collins

EXHIBIT A
AGREED SERVICE LIST

Linda L. Addison
FULBRIGHT & JAWORSKI, LLP
1301 McKinney, Suite 5100
Houston, TX 77010
Phone: 713-651-5621
Fax: 713-651-5246
E-mail: laddison@fulbright.com
Attorney for The Northern Trust Company and Northern Trust Retirement Consulting, L.L.C.

Steve W. Berman
Clyde A. Platt, Jr.
HAGENS BERMAN, LLP
1301 Fifth Avenue, Suite 2900
Seattle, WA 98101
Phone: 206-623-7292
Fax: 206-623-0594
E-mail: steve@hagens-berman.com
Co-Lead counsel for the *Tittle* Plaintiffs

Robert Hayden Burns
BURNS, WOOLEY & MARSEGLIA
1111 Bagby, Suite 4900
Houston, Texas 77002
Phone: 713-651-0422
Fax: 713-751-0817
Email: hburns@bwmzlaw.com
Attorney for Defendant Kristina Mordaunt

Jeremy L. Doyle
GIBBS & BRUNS, L.L.P.
1100 Louisiana, Suite 5300
Houston, TX 77002
Phone: 713-650-8805
Fax: 713-750-0903
Email: jdoyle@gibbs-bruns.com
Attorney for Defendants Robert A. Belfer, Norman P. Blake, Ronnie C. Chan, John H. Duncan, Joe Foy, Wendy L. Gramm, Robert K. Jaedicke, Charles A. LeMaistre, John Menldelsohn, Jerome Meyer, Paulo V. Ferraz Pereira, Frank Savage, Charls E. Walker, John Wakeham, Herbert Winokur

Anthony C. Epstein
Paul J. Ondrasik, Jr.
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
Phone: (202) 429-8065
Fax: (202) 261-7507
Email: aepstein@steptoe.com
Attorney for Philip J. Bazelides, Mary Joyce, and James S. Prentice

Sean G. Jez
FLEMING & ASSOCIATES, L.L.P.
1330 Post Oak Blvd., Suite 3030
Houston, TX 77056
Phone: 713-621-7944
Fax: 713-621-9638
Email: enron@fleming-law.com
Attorney for Individual Plaintiffs

Barry Flynn
LAW OFFICE OF BARRY G. FLYNN, P.C.
1300 Post Oak Blvd., Suite 750
Houston, TX 77056
Phone: 713-840-7474
Fax: 713-840-0311
Email: bgflaw@mywavenet.com
Attorney for David Duncan

Mark K. Glasser
KING & SPALDING
1100 Louisiana, Suite 4000
Houston, TX 77002
Phone: 713-751-3200
Fax: 713-751-3290
Email: mkglasser@kslaw.com
Attorney for LJM2 Co-Investment, L.P.

H. Bruce Golden
GOLDEN & OWENS LLP
1221 McKinney St., Suite 3600
Houston, TX 77010-20101
Phone: 713-223-2600
Fax: 713-223-5002
Email: golden@goldenowens.com
Attorney for John A. Urquhart

Roger B. Greenberg
SCHWARTZ JUNELL CAMPBELL & OATHOUT, LLP
909 Fannin, Suite 2000
Houston, TX 77010
Phone: 713-752-0017
Fax: 713-752-0327
Email: rgreenberg@schwartz-junell.com
Attorney for The Regents of the University of California

Mark C. Hansen
Reid M. Figel
KELLOGG, HUBER HANSEN, TODD & EVANS PLLC
1615 M. Street, N.W., Suite 400
Washington, D.C. 20036
Phone: 202-326-7900
Fax: 202-326-7999
Email: mhansen@khhte.com
rfigel@khhte.com
Attorney for Defendant Nancy Temple

Rusty Hardin
RUSTY HARDIN & ASSOCIATES, P.C.
1201 Louisiana, Suite 3300
Houston, Texas 77002
Phone: 713-652-9000
Fax: 713-652-9800
Email: rhardin@rustyhardin.com
Attorney for Arthur Andersen, LLP

Robin L. Harrison
Justin M. Campbell III
CAMPBELL HARRISON & DAGLEY, LLP
4000 Two Houton Center
909 Fannin Street
Houston, TX 77010
Phone: 713-752-2332
Fax: 713-752-2330
Email: rharrison@chd-law.com
Liaison counsel for the *Tittle* Plaintiffs

Sharon Katz
DAVIS POLK & WARDWELL
450 Lexington Avenue
New York, NY 10017
Phone: 212-450-4000
Fax: 212-450-3633
Email: andersen.courtpapers@dpw.com
Attorney for Arthur Andersen LLP

Charles G. King
KING & PENNINGTON, L.L.P.
711 Louisiana Street, Suite 3100
Houston, TX 77002
Phone: 713-225-8404
Fax: 713-225-8488 (fax)
Email: cking@kandplaw.com
Attorney for Goldman Sachs, Salomon Smith Barney, and Banc of America Securities

Jeffrey C. King
HUGHES & LUCE, L.L.P.
1717 Main Street, Suite 2800
Dallas, Texas 75201
Phone: 214-939-5900
Fax: 214-939-6100
Email: kingj@hughesluce.com
Attorney for Bruce G. Willison

Bernard V. Preziosi, Jr.
CURTIS, MALLET-PREVOST, COLT & MOSLE LLP
101 Park Avenue
New York, NY 10178-0061
Phone: 212-696-6000
Fax: 212-697-1559
Email: bpreziosi@cm-p.com
Attorney for Michael C. Odom

William S. Lerach
G. Ppaul Howes
Helen J. Hodges
MILBERG WEISS BERSHAD HYNES & LERACH, LLP
401 B Street, Suite 1700
San Diego, CA 92101
Phone: 619-231-1058
Fax: 619-231-7423
Email: enron@milberg.com
Attorney for The Regents of the University of California and Lead Counsel for the *Newby* Plaintiffs

Dr. Bonnee Linden, Pro Se
LINDEN COLLINS ASSOCIATES
1226 West Broadway
P. O. Box 114
Hewlett, NY 11557
Phone: 516-295-7906
[SEND VIA MAIL PER DR. LINDEN]

Kenneth S. Marks
SUSMAN GODFREY, L.L.P.
1000 Louisiana, Suite 5100
Houston, TX 77002-5096
Phone: 713-651-9366
Fax: 713-654-6666
Email: kmarks@susmangodfrey.com
Attorney for Defendant Enron Corporation

James F. Marshall
JUDICIAL WATCH, INC.
2540 Huntington Drive, Suite 201
San Marino, CA 91008-2601
Phone: 626-287-4540
Fax: 626-237-2003
Email: marsall@attglobal.net
Attorney for *Wilt* Plaintiffs

William F. Martson, Jr.
TONKON TORP, L.L.P.
1600 Pioneer Tower
888 S.W. Fifth Avenue
Portland, OR 97204-2099
Phone: 503-803-2005
Fax: 503-972-74073705
Email: enronservice@tonkon.com
Attorney for Ken L. Harrison

John J. McKetta, III
GRAVES, DOUGHERTY, HEARON & MOODY, P.C.
515 Congress Ave., Suite 2300
Austin, TX 78701
Phone: 512-480-5600
Fax: 512-478-1976
Email: mmcketta@gdhm.com
Attorneys for Rebecca Mark-Jusbasche

Andrew J. Mytelka
M. David Le Blanc
GREER, HERZ & ADAMS, L.L.P.
One Moody Plaza, 18th Floor
Galveston, TX 77550
Phone: 409-797-3200
Fax: 409-766-6424
Email: dleblanc@greerherz.com
bnew@greerherz.com
amytelka@greerherz.com
swindsor@greerherz.com
Attorney for *American National* Plaintiffs

John L. Murchison, Jr.
VINSON & ELKINS, L.L.P.
2300 First City Tower
1001 Fannin
Houston, TX 77002
Phone: 713-758-2222
Fax: 713-758-2346
Email: jmurchison@velaw.com

Eric J. R. Nichols
Beck, REDDEN & SECREST
1221 McKinney Street, Suite 4500
Houston, TX 77010
Phone: 713-951-3700
Fax: 713-951-3720
Email: enichols@brsfirm.com
Attorney for Michael J. Kopper, Chewco Investments, L.P., and LJM Cayman, L.P.

Jack C. Nickens
NICKENS, LAWLESS & FLACK, L.L.P.
1000 Louisiana Street, Suite 5360
Houston, TX 77002
Phone: 713-571-9191
Fax: 713-571-9652
Email: trichardson@nlf.law.com
Attorney for The Estate of J. Clifford Baxter, Deceased, Richard B. Buy, Richard A. Causey, Mark A. Frevert, Joseph M. Hirko, Stanley C. Horton, Mark E. Koenig, Jeffrey McMahon, Michael S. McConnell, J. Mark Metts, Cindy K. Olson, Kenneth D. Rice, Joseph W. Sutton, and Paula Rieker

Gary A. Orseck
ROBBINS, RUSSELL, ENGLERT, ORSECK & UNTEREINER, LLP
1801 K Street, N.W., Suite 411
Washington, D.C. 20006
Phone: 202-775-4500
Fax: 202-775-4510
Email: gorsek@robbinsrussell.com
Attorney for Michael Lowther

Lynn Lincoln Sarko
KELLER ROHRBACK LLP
1201 Third Ave., Suite 3200
Seattle, WA 98101-3052
Phone: 206-623-1900
Fax: 206-623-3384
Email: lsarko@kellerrohrback.com
Co-Lead Counsel for the *Tittle* Plaintiffs

Scott B. Schreiber
ARNOLD & PORTER
255 Twelfth Street, NW
Washington, DC 20004-1206
Phone: 202-942-5000
Fax: 202-942-5999
Email: enroncourtpapers@aporter.com
Attorney for Tom Bauer

Henry F. Schuelke, III
Robert Sutton
JANIS, SCHUELKE & WECHSLER
1728 Massachusetts Ave., N.W.
Washington, D.C. 20036
Phone: 202-861-0600
Fax: 202-223-7230
Email: hsschuelke@janisschuelke.com
rsutton@janisschuelke.com
Attorney for Ben Glisan

Billy Shepherd
CRUSE, SCOTT, HENDERSON & ALLEN, L.L.P.
600 Travis Street, Suite 3900
Houston, TX 77002-2910
Phone: 713-650-6600
Fax: 713-650-1720
Email: bshepherd@crusescott.com
Attorney for D. Stephen Goddard, Jr.

Craig Smyser, Esq.
SMYSER KAPLAN & VESELKA LLP
700 Louisiana, Suite 2300
Houston, TX 77002
Phone: 713-221-2300
Fax: 713-221-2320
Email: enronservice@skv.com
Attorney for Andrew S. Fastow

Robert M. Stern
O'MELVENY & MYERS LLP
555 13th Street, N.W., Suite 500W
Washington, DC 20004-1109
Phone: 202-383-5328
Fax: 202-383-5414
Email: rstern@omm.com
Attorney for Jeffrey K. Skilling

Abigail K. Sullivan
BRACEWELL & PATTERSON, L.L.P.
711 Louisiana Street, Suite 2900
Houston, TX 77002-2781
Phone: 713-221-1205
Fax: 713-221-2149
Email asullivan@bracepatt.com
Attorney for James V. Derrick

John K. Villa
WILLIAMS & CONNOLLY L.L.P.
725 Twelfth Street, N.W.
Washington, D.C. 20005-5901
Phone: 202-434-5000
Fax: 202-434-5705
Email: jvilla@wc.com
Attorney for Vinson & Elkins, L.L.P., Ronald T. Astin, Joseph Dilg, Michael P. Finch and Max Hendrick III

Carolyn S. Schwartz
United States Trustee, Region 2
33 Whitehall St., 21st Floor
New York, NY 10004
Phone: 212-510-0500
Fax: 212-668-2255
Trustee for Enron, Debtor

Paul Vizcarrondo, Jr.
WACHTELL, LIPTON, ROSEN & KATZ
51 West 52nd Street
New York, NY 10019-6150
Phone: 212-403-1000
Fax: 212-403-2000 (fax)
Email: pvizcarrondo@wlrk.com
Attorney for Banc of Goldman Sachs, Salomon Smith Barney, and Banc of America Securities, LLC

Richard Mithoff
MITHOFF & JACKS
500 Dallas, Penthouse
Houston, TX 77002
Phone: 713-654-1122
Fax: 713-739-8085
Email: enronlitigation@mithoff-jacks.com
cgall@jenkens.com
t_rice@stblaw.com
Attorneys for J.P. Morgan Chase & Co.

Taylor M. Hicks
HICKS THOMAS & LILIENSTERN, LLP
700 Louisiana, Suite 1700
Houston, TX 77002
Phone: 713-547-9100
Fax: 713-547-9150
Email: thicks@hicks-thomas.com
Attorney for Merrill Lynch & Co., Inc.

Paul J. Ondrasik, Jr.
F. Michael Kail
Anthony C. Epstein
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
Phone: (202) 429-3000
General Fax: (202) 429-3902
Email: pondrasik@steptoe.com
Attorneys for James G. Barnhart, Keith Crane, William Gulyassy, Roderick Hayslett, Sheila Knudsen, Tod A. Lindholm, Mikie Rath, and David Shields

William Edward Matthews
GARDERE WYNN SEWELL, LLP
1000 Louisiana, Suite 3400
Houston, TX 77002
Phone: 713-276-5500
Fax: 713-308-5555
Email: wmatthews@gardere.com
Attorneys for Defendant Andersen Worldwide, S.C.

Jacalyn D. Scott
WILSHIRE SCOTT & DYER, PC
1221 McKinney, Suite 3000
Houston, TX 77001
Phone: 713-651-1221
Fax: 713-651-0020
Email: jscott@wsd-law.com
Attorneys for Defendants CitiGroup, Inc. and Salomon Smith Barney, Inc.

Michael Connelly
CONNELLY, BAKER, WOTRING & JACKSON
700 Louisiana Street, Suite 1850
Houston, TX 77002
Phone: 713-980-1711
Fax: 713-980-1701
Email: mconnelly@connellybaker.com
Attorney for Kirkland and Ellis

Alan N. Salpeter
Michele Odorizzi
T. Mark McLaughlin
MAYER, BROWN, ROWE & MAY
190 South LaSalle Street
Chicago, IL 60603
Phone: 312-782-0600
Fax: 312-706-8680
Email: asalpeter@mayerbrownrowe.com
modorizzi@mayerbrownrowe.com
mmclaughlin@mayerbrownrowe.com
Attorneys for Defendant Canadian Imperial Bank of Commerce

James N. Benedict
Mark A. Kirsch
James F. Moyle
CLIFFORD CHANCE ROGERS & WELLS, L.L.P.
200 Park Ave., Suite 5200
New York, NY 10166
Phone: 212-878-8000
Fax: 212-878-8375
Email: james.benedict@cliffordchance.com
mark.kirsch@cliffordchance.com
james.moyle@cliffordchance.com
Attorneys for Defendant Alliance Capital Management

Ronald E. Cook
COOK & ROACH, LLP
1111 Bagby Street, Suite 2650
Houston, TX 77002
Phone: 713-652-2031
Fax: 713-652-2029
Email: rcook@cookroach.com
Attorney for Defendant Alliance Capital Management L.P.

Brad S. Karp
Mark F. Pomerantz
Richard Rosen
PAUL, WEISS, RIFKIND, WHARTON & GARRISON
1285 Avenue of the Americas
New York, NY 10019
Phone: 212-373-3000
Fax: 212-575-3990
Email: grp-citi-service@paulweiss.com
Attorneys for Defendant CitiGroup, Inc.

Lawrence Byrne
Owen C. Pell
Lance Croffoot-Suede
WHITE & CASE, L.L.P.
1155 Avenue of the Americas
New York, NY 10036
Phone: 212-819-8200
Fax: 212-354-8113
Email: lbyrne@whitecase.com
opell@whitecase.com
lcroffoot-suede@whitecase.com
Attorneys for Defendant Deutsche Bank AG

Richard W. Clary
Julie A. North
CRAVATH, SWAINE & MOORE
813 Eight Avenue
New York, NY 10019
Phone: 212-474-1000
Fax: 212-474-3700
Email: rclary@cravath.com
jnorth@cravath.com
Attorneys for Defendant Credit Suisse First Boston Corp.

Lawrence D. Finder
HAYNES & BOONE, L.L.P.
1000 Louisiana, Suite 4300
Houston, TX 77002
Phone: 713-547-2006
Fax: 713-547-2600
Email: finderl@haynesboone.com
Attorneys for Defendant Credit Suisse First Boston Corp.

David H. Braff
SULLIVAN & CROMWELL
125 Broad Street
New York, NY 10004-2498
Phone: 212-558-4000
Fax: 212-558-3588
Email: braffd@sullcrom.com
candidoa@sullcrom.com
brebnera@sullcrom.com
Attorneys for Defendant Barclays Bank

Gregory A. Markel
Ronit Setton
Nancy Ruskin
BROBECK, PHLEGER & HARRISON, LLP
1633 Broadway, 47th Floor
New York, NY 10019
Phone: 212-581-1600
Fax: 212-586-7878
Email: gmarkel@brobeck.com
rsetton@brobeck.com
nruskin@brobeck.com
Attorneys for Defendant Bank of America Corp.

Paul R. Bessette
Michael J. Biles
BROBECK, PHLEGER & HARRISON, LLP
401 Plaza on the Lake
Austin, TX 78746
Phone: 512-330-4000
Fax: 512-330-4001
Email: pbessette@brobeck.com
mbiles@brobeck.com
Attorneys for Defendant Bank of America Corp.

Dennis H. Tracey, III
David F. Wertheimer
Hogan & Hartson, L.L.P.
875 Third Avenue
New York, NY 10022
Phone: 212-918-3000
Fax: 212-918-3100
Email: dhtracey@hhlaw.com
dfwertheimer@hhlaw.com
Attorneys for Defendant Debra Cash

Murry Fogler
McDade Fogler Maines, L.L.P.
909 Fannin, Suite 1200
Houston, TX 77010-1006
Phone: 713-654-4300
Fax: 713-654-4343
Email: mfogler@mfml.com
Attorneys for Lou L. Pai

Roger E. Zuckerman
Steven M. Salky
Deborah J. Jeffrey
ZUCKERMAN SPAEDER LLP
1201 Connecticut Avenut, N.W.
Washington, D.C. 20036-2638
Phone: 202-778-1800
Fax: 202-822-8106
Email: djeffrey@zuckerman.com
Attorneys for Lou L. Pai

Table 1: Summary of Class Period Sales of Enron Shares by Ken Lay Based on SEC Filings

	Shares			Gross Proceeds		Costs	
	Amount	% of Holdings [1]	% of All Sales	Amount	% of Gross Proceeds	Exercise Costs	Taxes and Other Costs
All Sales	4,878,700	46.24%	100.00%	$234,139,766	100.00%	*	*
1) Cashless exercises							
1A: Options expiring within class period							
Expiring options used in program sales	224,100	2.12%	4.59%	$17,292,690	7.39%	$3,909,663	*
Other options expiring in class period	855,501	8.11%	17.54%	$51,617,042	22.05%	$9,699,183	*
1B: Program sales other than expiring options	433,009	4.10%	8.88%	$25,543,383	10.91%	$8,208,633	*
1C: Non-program, non-expiring cashless exercises (none after April 2000)	926,722	8.78%	19.00%	$33,714,856	14.40%	$8,732,830	*
2) Loan repayments (2001)	1,775,558	16.83%	36.39%	$70,105,844	29.94%	*	*
3) Other	663,810	6.29%	13.61%	$35,865,951	15.32%	*	*
Totals:	4,878,700	46.24%	100.00%	$234,139,766	100.00%	*	*

Total gross proceeds		$234,139,766
Purchases via option exercises: held & not sold	$6,468,131	
Partial exercise costs for shares exercised and sold, to the extent included in SEC filings	$30,550,308	
Partial cost basis included in SEC filings		$37,018,439
Gross proceeds less partial cost basis		$197,121,327

*** Not required to be included in SEC filings**

(1) "Holdings" defined as class period sales plus 11/30/01 holdings of vested options and stock other than restricted stock
Excluded from holdings are 249,264 shares of restricted stock, disclosed in 2001 proxy statement filed by Enron (page 19)
Also excluded from holdings are 578,614 shares gifted during the class period

EXHIBIT NO. 1

Table 2: Potential Gross Proceeds* Compared to Actual Gross Proceeds from Sale of Enron Stock by Ken Lay in Class Period

Month ended	Available holdings: Stock (except restricted) plus in-the-money options	Maximum daily closing price in month	Potential gross proceeds - if remaining holdings liquidated at high daily closing price*	Actual cumulative gross proceeds through month-end
10/31/98	6,560,311	$26.56	$ 174,258,251	$ 2,526,031
11/30/98	7,393,358	$29.16	$ 218,088,611	$ 2,526,031
12/31/98	7,393,358	$29.34	$ 219,474,866	$ 9,713,503
01/31/99	7,373,358	$33.44	$ 256,260,145	$ 9,713,503
02/28/99	7,229,821	$34.13	$ 256,431,135	$ 16,130,634
03/31/99	7,403,645	$35.28	$ 277,340,474	$ 16,130,634
04/30/99	7,217,489	$37.63	$ 287,688,647	$ 23,157,719
05/31/99	7,893,895	$38.47	$ 326,825,974	$ 35,898,391
06/30/99	7,637,351	$41.09	$ 349,745,763	$ 35,898,391
07/31/99	6,838,357	$43.19	$ 331,229,912	$ 44,855,576
08/31/99	6,772,287	$44.31	$ 344,952,539	$ 44,855,576
09/30/99	6,561,517	$42.81	$ 325,770,518	$ 50,843,524
10/31/99	6,536,797	$40.94	$ 318,443,663	$ 50,843,524
11/30/99	6,388,181	$42.63	$ 323,139,738	$ 56,296,826
12/31/99	6,388,181	$44.38	$ 339,772,357	$ 56,296,826
01/31/00	6,172,860	$71.63	$ 498,427,915	$ 64,034,064
02/29/00	7,748,548	$70.31	$ 608,853,874	$ 68,519,546
03/31/00	7,711,652	$76.50	$ 658,460,954	$ 73,523,195
04/30/00	7,486,205	$73.81	$ 626,098,666	$ 85,687,449
05/31/00	7,302,664	$77.88	$ 654,382,380	$ 102,639,582
06/30/00	7,078,642	$74.19	$ 627,786,330	$ 102,639,582
07/31/00	6,847,036	$77.00	$ 629,861,352	$ 102,639,582
08/31/00	6,840,963	$90.00	$ 718,326,262	$ 113,184,906
09/30/00	**6,836,422**	**$89.63**	**$ 725,899,189**	$ 113,184,906
10/31/00	6,665,765	$86.44	$ 689,356,962	$ 113,184,906
11/30/00	6,663,442	$83.25	$ 667,916,437	$ 123,975,320
12/31/00	6,663,467	$84.63	$ 687,871,252	$ 134,121,333
01/31/01	6,523,901	$82.00	$ 669,081,244	$ 140,442,244
02/28/01	6,786,781	$81.81	$ 695,668,802	$ 148,825,378
03/31/01	7,851,560	$70.59	$ 703,066,937	$ 153,008,942
04/30/01	7,668,571	$63.66	$ 641,190,142	$ 160,573,135
05/31/01	7,558,862	$62.41	$ 632,321,716	$ 172,947,857
06/30/01	7,434,727	$54.54	$ 578,437,893	$ 200,522,223
07/31/01	7,214,120	$49.94	$ 560,795,354	$ 208,072,210
08/31/01	6,620,679	$45.61	$ 510,041,368	$ 224,087,424
09/30/01	6,076,712	$35.00	$ 436,772,358	$ 228,089,534
10/31/01	4,985,144	$36.79	$ 411,492,977	$ 234,139,766
11/30/01	4,415,553	$11.99	$ 287,082,247	**$ 234,139,766**

Maximum potential gross proceeds	**$ 725,899,189**
Actual gross proceeds as percentage of potential gross proceeds	**32.26%**

* Potential gross proceeds defined as total gross proceeds realized prior to the month, plus available holdings times the maximum daily closing price for the month.

EXHIBIT NO. 2

Table 3: Average Sales Price of Enron Shares Sold by Ken Lay in Class Period

Total shares sold		4,878,700
Total gross sales proceeds	$	234,139,766
Average sales price	$	47.99
Class period high closing share price	$	90.00
Average sales price as % of high price		**53.32%**

EXHIBIT NO. 3

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, ET AL.,	§	
	§	
Plaintiffs,	§	
	§	**CIVIL ACTION NO: H-01-3624**
v.	§	**AND CONSOLIDATED CASES**
	§	
ENRON CORPORATION, ET AL.,	§	
	§	
Defendants.	§	

ORDER GRANTING DEFENDANT KENNETH L. LAY'S MOTION TO DISMISS

The Court, having reviewed Defendant Kenneth L. Lay's Motion to Dismiss and all relevant pleadings and briefs on file related to the motion, and being of the opinion that said motion should be granted, it is therefore,

ORDERED that the claims against Defendant Kenneth L. Lay pleaded in Plaintiffs' Consolidated Complaint, and are hereby, dismissed entirely pursuant to Fed. R. Civ. P. 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(1).

SIGNED in Houston, Texas, this ___ day of ____________, 2002.

____
MELINDA HARMON
UNITED STATES DISTRICT JUDGE